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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

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| Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products | Docket No. RM2017-3 |

**COMMENTS OF THE NATIONAL POSTAL POLICY COUNCIL,**
**THE MAJOR MAILERS ASSOCIATION,**
**THE NATIONAL ASSOCIATION OF PRESORT MAILERS,**
**AND THE ASSOCIATION FOR MAIL ELECTRONIC ENHANCEMENT**

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February 3, 2020

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(February 3, 2020)

The National Postal Policy Council ("NPPC"), the Major Mailers Association ("MMA"), the National Association of Presort Mailers ("NAPM"), and the Association for Mail Electronic Enhancement ("AMEE"), collectively the "First-Class Business Mailers," hereby respectfully address the proposals set forth in Order No. 5337, presented in a *Revised Notice of Proposed Rulemaking* in this proceeding.[1]

NPPC is an association of large business users of letter mail, primarily the Automation rate category in First-Class Mail, with member companies from the telecommunications, banking and financial services, insurance, subscription service, and mail services industries. Both price levels and discount

[1] Order No. 5337 (Dec. 5, 2019) ("*Revised NPRM" or "RNPRM*"). By submitting these comments, NPPC does not waive its concerns about Order No. 4257, for which it has filed a Petition for Review. *National Postal Policy Council v. Postal Regulatory Commission*, Case No. 17-1276 (D.C. Cir. order holding in abeyance Feb. 15, 2018).

passthroughs in Presort Letters are vital considerations in NPPC members' mailing decisions.

MMA membership is comprised of companies that serve the communications, utilities, insurance, banking, financial services, healthcare, government, and cable/satellite industries. Despite some diversion to electronic channels, these industries still rely primarily on the Postal Service for delivery of their statements, invoices, remittance payments, and other business communications.

NAPM is a nonprofit organization that represents mailers, both mail owners and mailing service providers who commingle, sort and prepare quality mailings inducted and compliant with work share requirements. NAPM member mail service provider companies interact with and perform mailing services for tens of thousands of clients and businesses nationally on a daily basis that use postal mailing products.

AMEE has 40 member companies representing mailers, associations, and supporting vendors who have a primary interest in increasing the value and utility of First-Class Mail and are engaged in developing or promoting technology in the area of mail electronic enhancement.

Collectively, the First-Class Business Mailers account for the vast majority of First-Class Presort mail volume in the postal system and a substantial portion of mailing industry employment. They work closely with the Postal Service on worksharing and many other efforts to make their mail as efficient and low cost as possible.

Today, postage generally accounts for 70 to 75 percent of the cost of a mailing, with everything else (software, hardware, staff, paper, etc.) comprising the remainder. Not long ago, postage was approximately one-third of the cost of a mailing (along with paper and production), but postal rates have risen steadily in recent years even while mailing printing and production costs have declined.

Because postage comprises such a large part of the total costs of a mailing, First-Class business mailers have strong internally-driven pressures to reduce, or at least stabilize, postage expenses. Their growing use of electronic alternatives since 2006 is a direct consequence of steadily increasing costs of using the mail (including both postage and other costs that the Postal Service has shifted onto mailers). Neither the Commission nor the Postal Service should assume, nor is there any evidence to suggest, that current First-Class Presort volume is in any sense "permanent" or even that the current rates of decline would not accelerate if postage rates were to rise by more than CPI.

The First-Class Business Mailers support efforts to reduce postal costs and increase efficiency in pricing and operations, and well as innovations to increase volumes. But simply raising postage without guarantees of improved efficiency or better actual service will only drive mail away. Accordingly, while the First-Class Business Mailers urge the Commission to adopt the worksharing proposal, it should withdraw the density, retirement, and service performance proposals, and defer to the Governors, incoming Postmaster General, and Congress to address the financial issues.

## I. INTRODUCTION AND SUMMARY

In Order No. 4257, the Commission concluded that the system for regulating the rates of the Postal Service's market-dominant products designed in 2007-2008 has not adequately achieved three of the nine Objectives established by Congress in 39 U.S.C. §3622(b). The Commission decided that the current system has not maximized the incentives for cost minimization and efficiency contrary to Objective 1, has not assured high-quality service standards contrary to Objective 3, and, based on a non-statutory definition, has not assured adequate revenues for financial stability contrary to Objective 5.

The Commission proposed changes to the current system to address those three purported failures in Order No. 4258. Order No. 5337 modifies those proposed changes.

The First-Class Business Mailers acknowledge the substantial time and effort taken by the Commission and its staff to wrestle with the issues in this docket. In particular, the revised proposal to address the failure to achieve Objective 1 by requiring greater use of Efficient Component Pricing in worksharing discounts is long overdue and should be adopted, modified as described in Section II. The Postal Service's failure to restrain and reduce costs sufficiently as volumes fall is a major ongoing problem, and more efficient pricing will be an important step in the correct direction. The Commission can implement its worksharing discount proposal with its existing legal authority, and we urge it to do so. Adopting the workshare proposal would also facilitate the Postal Service's intent, as stated in its Strategic Plan, to "[e]xpand partnerships where best aligned to improve service reliability, lower costs, and increase capabilities."[2]

In contrast, the other proposals in the *Revised NPRM* offer little hope of correcting what Order No. 4257 concluded were failures to achieve Objectives 3 and 5. The *Revised NPRM* would give the Postal Service authority for higher rates in three ways: a supplemental "density rate," "supplemental" authority to collect above-cap revenue to make payments towards the unrealistic retirement prefunding obligations, and a reward for "service performance" based on improving Total Factor Productivity and maintaining published service standards and associated business rules.[3]

Before turning to the merits of these rate authority proposals, the First-Class Business Mailers feel compelled to point out that the Postal Service has simply not controlled costs sufficiently under the PAEA price cap. While commendably constraining costs to some degree overall (albeit with harmful service degradation), the Postal Service has been unwilling or unable to constrain labor costs, which persistently, and still, comprise approximately 80 percent of total costs. In FY2019, labor costs were the key component in a substantial increase in operational controllable costs. Moreover, in its latest contract with the NPMHU, the Postal Service has agreed to convert thousands of

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[2] *Postal Service Five Year Strategic Plan 2020-2024*, at 26 ("*USPS Strategic Plan*"). To that end, the Plan, which the Governors have endorsed, states that the Service "will continue to develop pricing incentives and invest in platforms that reinforce efficiency and service improvement." *Id*. at 33.

[3] The First-Class Business Mailers are not addressing the proposal to confer an optional additional 2 percent rate authority for non-compensatory classes.

"casual" workers to career status, thereby raising costs substantially and permanently.

Further, the Postal Service has failed to hold, or been stopped by binding arbitration from holding, the line on raises and cost-of-living adjustments in collective bargaining, resulting in unaffordable increases. We recognize that the Postal Service's workers are vital to its success and are rightfully applauded for their service to the community, but their compensation cannot and should not be delinked from the overall success of the enterprise. When the Postal Service experiences genuine growth, as measured by both volume and revenue, its workers should share in that improvement. But when its volumes are declining, wages and benefits should not increase.

The *Revised NPRM*'s proposed rate authorities will allow rates to rise beyond tolerance. That might (but not necessarily), in the short term, provide more revenue. But as was seen from the lagging effects of the exigency surcharge, these increases, if implemented, will cause substantial declines in postal business.[4] While it can be appropriate for employees to share in any growth that a business such as the Postal Service may enjoy, they are not entitled to an ever=larger share of a declining business. The Commission's proposed new rate authorities, if adopted, would gut the only restraint that may now exist on postal labor costs.

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[4] For many business mailers, years may be required to adjust to rate changes. In the case of Presort Letters, the lagged effect of the exigency surcharge took hold in FY2017 and has continued in the ensuing years. The threat of higher rates emerging from this proceeding has caused business mailers to redouble efforts to divert still more mail.

To illustrate, using the Postal Service's own estimates of volume decreases and delivery point increases presented in its recently released Five Year Strategic Plan, the *Revised NPRM*'s density factor alone would allow rates to increase by 10.76 percent by FY2024, but as designed there is no ceiling to the possible increases that the formula could generate in any single year, or over time. The *Revised NPRM* does not even consider that controlling labor costs could substantially restrain delivery costs, not does it consider that the density factor completely undercuts the cost control purpose of the CPI price cap.

The retirement factor -- also based on a formula but phased in over five years – would call for a total rate increase that is unknown (and also potentially unlimited) but, using the examples in the *Revised NPRM*, approximately 1 percent per year. And the "service performance" authority could be another 1 percent increase annually with no expiration. These rough estimates sum to 20 percent or more *on top of inflation* after a mere five years (CPI itself could sum to more than 10 percent during that same time) and would be still higher if volume declines exceed the Postal Service's current projections. The size of the authorized increase in any given year would be neither predictable nor stable, as two of the factors have no annual limit and none of the three has a cumulative ceiling.[5] These indeterminate but unlimited proposals should not be adopted.

The fundamental problem with these rate proposals is that the Commission is eviscerating the central cost restraining tool in the PAEA while

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[5] The retirement authority would phase-in over five years, but there is no ceiling to the amount. The service performance authority is one percent per year but would be available indefinitely.

also trying to address an unreasonable retirement funding obligation created by Congress, and that only Congress can resolve. In addition to the Postal Service's insufficient cost control, the retiree benefit prefunding obligation imposed by Congress in the PAEA – at a time when postal volumes were expected to continue to grow -- is the root of the Postal Service's balance-sheet issues that drives the Commission's proposals.[6] The balance sheet deficit has occurred because the volume expectation proved incorrect, but Congress has not yet recognized the changed conditions and amended the law.

While only Congress can change that statutory obligation, the reality is that the Postal Service has not made the prefunding payments since FY2011 and has suffered no adverse consequences for failing to do so. At present, the Postal Service has ample funds to pay its employees' retirement benefits for years. There is no urgency, nor is it appropriate, for a regulatory agency to rely on the comparatively few tools at its disposal to "fix" a broader issue between the Congress and the Postal Service that has arisen because the expectations underlying the PAEA turned out to be incorrect. Nor should the regulator essentially eliminate the primary provision of the law that requires the Postal Service to make any effort to control costs.

[6] The Postal Service recently stated that retiree-related expenses account for 98 percent of its net losses since 2007. *USPS Strategic Plan*, at 12. The lump sum and amortization payments alone account for 84 percent of its losses. *Id*. Any business will have year-to-year fluctuations in operations. The Postal Service reported a "controllable" loss of $3.4 billion in FY2019. *United States Postal Service FY2019 Annual Report to Congress* at 30. However, that was the only loss of that size in recent years, and it showed an operating profit as recently as FY2016. *See United States Postal Service FY2016 Report on Form 10-K*, at 15.

That the Commission is stretching to address a perceived problem not of its own making but that is due to an incorrect assumption by Congress that underlies the PAEA may explain the deficiencies in its rate proposals. First, all of the so-called "supplemental" and "additional" rate authority are based on the Commission's erroneous belief that it has legal authority to allow the Postal Service to exceed the statutory rate cap. As the First-Class Business Mailers explained in previous comments in Phase II of this proceeding, which are hereby incorporated by reference and we reiterate here,[7] the Commission simply does not have the legal authority under the PAEA or the Constitution to allow the Postal Service to exceed the statutory price cap nor, as a policy matter, should it. The First-Class Business Mailers expressly preserve that position and by herein addressing the proposals in the *Revised NPRM* do not waive their legal objections to Commission actions that might allow the Postal Service to exceed or circumvent that price cap.

Second, the proposals (particularly those pertaining to Objective 5) are also flawed because they depend on a definition of financial stability that has no basis in the PAEA. The First-Class Business Mailers' comments in Phase II also explained that the correct definition of financial stability – one that is based on the

[7] *See Comments of the Major Mailers Association, The National Association of Presort Mailers, and the National Postal Policy Council*, Docket No. RM2017-3 (Mar. 20, 2017); *Comments of the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers*, Docket No. RM2017-3, at 19-41 (Mar. 1, 2018) ("*First-Class Business Mailers Phase II Comments*"). *See also National Postal Policy Council v. Postal Regulatory Commission*, Case No. 17-1276 (D.C. Cir. order holding petition for review in abeyance Feb. 15, 2018).

statutory text – instead focuses on the Service's ability to maintain and develop postal services, and the Commission has not applied that standard. Consequently, the proposals lack a sound foundation. Indeed, the *Revised NPRM* abandons any attempt to identify how much additional money the Postal Service might need in order to attain financial stability (much less one based on the statute).

Third, the Commission has not assessed the proposed new system that would be in place if the proposals in the *Revised NPRM* were adopted on the basis of the statutory Objectives (which must be applied in conjunction with one another), nor has it taken the statutory Factors into account. The Commission has focused exclusively on Objectives 1, 3, and 5, presumably because those are the Objectives that Order No. 4257 found are not met by the current system, and by focusing primarily on Objective 5 (other than for the worksharing provisions) has not truly addressed the tension between even those Objectives.

But any new system must also *continue to achieve* the *other* statutory Objectives and take into account the Factors as well. The Commission cannot simply assume that the fundamental changes it proposes would have no effect on continuing to achieve the Objectives and Factors that the current system *does* achieve – although the absence of any discussion of this matter suggests that it has assumed precisely that.[8] Importantly, the failure to take into account the reasonably anticipable effects on the predictability and stability of rates, the

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[8] Indeed, the only reference to the need to "provide a balance among the objectives" briefly nods to "reasonable rates" but focuses on Objectives 1, 3, and 5. *RNPRM* at 133.

harmful effects of unlimited rate increases on cost control efforts, and on mailers and future mail volumes, is unreasonable decisionmaking.

Fourth, the proposed new rate authorities are based on faulty premises and are not tailored to achieve their stated purpose. The density factor – which seeks to recover network costs while ignoring costs, revenues, and volumes -- erroneously treats non-volume variable costs as uncontrollable. It also would greatly over-recover delivery costs, as seen by comparing the formula to the established roll-forward model while diminishing the price cap pressure on the Postal Service to reduce network costs. Finally, by increasing rates still more as volume falls and service quality remains below promised levels, the density factor is a formula for actually precipitating the long-bruited postal death spiral.

The retirement payment authority would raise rates significantly and result in the Commission's directly regulating how the Postal Service spends money, thereby needlessly inserting itself into a problem between the Service and Congress. Mailers would pay more but see no effect on operations. Indeed, it would require no behavior change by the Postal Service other than requiring it to pay money collected for retirement into the retirement funds, and the Service apparently could choose not to do so in future years without losing any authority it had received to that point to collect such money, just as it has for years with the $3.1 billion it has collected annually since Docket No. R2005-1. And it, too, is designed to contribute to a death spiral as volume declines.

The proposal to allow an additional 1 percent rate authority for "service performance" is misguided as well. Improvement in Total Factor Productivity does not assure that productivity improves even if additional rate authority is granted and used. Furthermore, more revenue would be counterproductive by relaxing the pressure on the Postal Service's existing incentive to achieve positive TFP, and more money can readily worsen TFP performance.

And the service standards aspect of the proposal requires nothing of the Postal Service other than that it not lower official published service standards and business rules still more. The proposal would do nothing to achieve Objective 3, because it does not require that the Postal Service actually meet today's lesser standards, and there currently is no process for reviewing the Service's business rules or changes to them.[9] Indeed, under the proposal the Postal Service could freely degrade actual service with impunity, so long as it never formally fesses up to doing so in its standards or business rules. And the *Revised NPRM* would create a new incentive to do just that by establishing a financial reward for reducing investment or other expenses in order to boost TFP.

Fifth, the supplemental and additional rate authorities proposed in the *Revised NPRM* share a unidirectional focus: up. Should density increase, retirement payments be defaulted upon or repealed by Congress, or TFP and/or service standards decline, additional authority would not be granted, *but any authorities granted to that point would remain despite their justifications having disappeared.* All increases awarded to those points would simply be baked into the rate base, to be paid forever and compounded. The First-Class Business

[9] The Commission will need to adopt still additional measures in order to improve the transparency of the business rules. Far simpler would be to base any rate authority on actual performance.

Mailers believe the one-sided nature of these proposals is not only counterproductive but arbitrary. A balanced proposal should require a reduction of the “supplemental” or “additional” authority when the justification for the authority no longer holds true.

The proposed reporting mechanisms do not cure the deficiencies in the proposals. Reporting requirements have not proven to be an effective means of improving postal performance. Authority for higher rates, if unaccompanied by meaningful sanctions when conditions are not met, is not a solution but would simply exacerbate matters. And the Commission’s attempt to avoid the implications of the decision in *Carlson v. Postal Regulatory Commission,* 938 F.3d 337 (D.C. Cir. 2019) should be abandoned.

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The predictable consequence of the supplemental and additional rate authority proposals will be ever-spiraling rate increases, which in turn would accelerate and aggravate volume losses, which by the design of the proposed formulas would simply raise rates still higher. This would inevitably create a spiral down to the point that the user-fee model of the Postal Service would become unsustainable.

These concerns warrant regulatory restraint. Additional considerations warranting caution are that the Postal Service should soon have a new Postmaster General, who would bring new ideas to the agency, and the

Governors are working on strategic and financial initiatives.[10] At the same time, Congress has been asked to consider modifying the retiree prefunding obligations.

Given these many moving parts, it would be prudent for the Commission to move incrementally. The Commission's first step should be to improve the Postal Service's efficiency by adopting the worksharing proposal, which it has undisputed legal authority to do. But it should defer the supplemental and additional rate authority proposals – for which the Commission's legal authority is disputed and that would impose radical changes on the system. This deferral should last until the Postal Service's new leadership is in place, Congress has acted, the Postal Service has had time to innovate and implement its Strategic Plan, and there has been an opportunity to see what can be done with existing regulatory tools, and certainly until after it can reconcile the tension between its proposal and Objectives 1, 5, and 8 and the Factors. If the Postal Service can successfully take costs out of the system or increase volume, there would be much less need for proposals as drastic as those in the *Revised NPRM*.

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[10] The Governors recently released its strategic plan for the next five years, which identifies a number of initiatives to reshape the Service in the next future years. *See USPS Strategic Plan*. The First-Class Business Mailers welcome the opportunity to explore innovative public-private partnerships that can improve postal efficiency and service quality, but the precipitous rate proposals in the *Revised NPRM* would effectively cut off the opportunity to do so.

## II. THE COMMISSION SHOULD MAKE WORKSHARING DISCOUNTS MORE ECONOMICALLY EFFICIENT

The Commission proposes the following changes to its regulations governing workshare discounts:

- To prohibit changes to workshare discounts that already are equal to avoided costs;
- To prohibit reductions in workshare discounts that are below avoided costs;
- To prohibit increases in workshare discounts that are above avoided costs;
- To require the Postal Service to increase by at least 20 percent workshare discounts that passthrough less than 85 percent of the avoided costs;
- To require the Postal Service to decrease by at least 20 percent workshare discounts that passthrough more than 100 percent of the avoided costs;
- To address excessive discounts for mail consisting of ECSI matter conditioned on the Postal Service providing certain additional information;
- To allow the Postal Service to set new workshare discounts without restriction; and
- To allow the Postal Service to seek a waiver prior to the next rate adjustment to allow it to set a workshare discount contrary to the new rules.

*RNPRM* at 208.[11] These proposals are intended to bring workshare discounts more in accordance with Efficient Component Pricing ("ECP"), which the Commission has long recognized best promotes efficiency and reduces postal

[11] The proposal to confer additional rate authority on the basis of TFP improvement, which the *Revised NPRM* states would also bear on efficiency, is discussed *infra*.

costs as required by Objective 1. They are revised versions of ideas proposed in Order No. 4258.

Adopting them, but with the modification described herein, would be a long-needed step towards rates that promote greater efficiency, as required by Objective 1, consistent with Objectives 5 and 8 and Factors 4, 5, and 6, and either neutral or supportive of the other Objectives. As a general rule, the Postal Service should move all workshare discounts closer to ECP, because passthroughs of less than the full amount of avoided costs set inefficient pricing signals and pose a financial risk to the Service.[12]

The Commission has ample legal authority under the PAEA to adopt these regulations.[13] In particular, Sections 503 and 3622(a) grants the Commission authority to craft regulations consistent with Section 3622(e) to achieve Objective 1 and Factors 4, 5, 6, and 11.[14] These regulations plainly may include a presumption that workshare discounts should be set according to ECP principles, and a requirement the Postal Service to set non-compliant workshare discounts equal to avoided cost or move them 20 percent closer to that goal.

[12] NPPC explained in its comments in Docket No. R2020-1 that where a workshare discount passes through less than 100 percent of the avoided costs, the Postal Service loses money on every piece because the price being charged a mailer for the Postal Service to do the work instead is less than the cost incurred by the Postal Service in performing the work. *See Comments of the National Postal Policy Council*, Docket No. R2020-1, at 27-29 (Oct. 29, 2019).

[13] Unlike the previous proposal, the current proposal would not establish a presumption allowing the Postal Service to charge rates in excess of the statutory CPI price cap. *Accord RNPRM* at 203 (stating that the revised proposal "aligns more closely with 39 U.S.C. §3622(e)).

[14] Section 3622(e)(2)(C) gives the Commission authority to allow excessive passthroughs for worksharing discounts affecting ECSI mail matter.

However, as proposed the regulations are too permissive. This could allow the Postal Service to continue to avoid pricing according to ECP, thus defeating their very purpose.[15] In particular, Proposed rule § 3010.284(e), which in effect creates a “safe harbor” for discounts that passthrough only 85 percent of avoided costs, should not be adopted because in practice it will tend to migrate discounts to 85 percent instead of the desired 100 percent.

This will occur because Proposed rule § 3010.282(a) and (c) speak in terms of costs avoided instead of passthroughs. This could allow the Postal Service to misuse the regulation to set uneconomic discounts. For example, assume in Year 1 the Postal Service offers a workshare discount of $0.02, which equals the avoided costs. In Year 2, the costs avoided increase to $0.024. It would arguably be a permissible reading of proposed § 3010.282(a) for the Postal Service to maintain the discount at $0.02 (barely 85 percent), although doing so reduces efficiency. This is an undesirable outcome.[16]

Indeed, Proposed rule § 3010.282(a) perhaps could be expressed more precisely as:

> For a workshare discount that is equal to the cost avoided by the Postal Service for not providing the applicable service, no proposal to adjust a rate associated with that workshare discount may cause the discount not to equal the costs avoided.

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[15] The Commission acknowledges that the “Postal Service had the ability to adhere to ECP throughout the PAEA era but did not do so.” *RNPRM* at 195.

[16] The same loophole applies to discounts subject to Proposed rule § 3010.282(c). If a discount is unchanged while the avoided costs increase, the passthrough becomes less efficient.

Thus, and contrary to Proposed rule § 3010.284(e), discounts that passthrough 85 to 99 percent of avoided costs should be increased in the same manner as the *Revised NPRM* proposes for other passthroughs.

The Commission also has proposed a means for the Postal Service to seek waivers at least 60 days before proposing to set workshare discounts at levels inconsistent with the proposed rules. This advance filing requirement should be adopted, as it will prevent the Postal Service from announcing non-compliant rates in a notice of rate adjustment, which as the Commission noted allows little time for parties and the Commission to respond or for the Service to file alternative rates if the Commission rejects them. *See RNPRM* at 208.

However, the most important aspect of the waiver process is the standard that the Commission will apply. The Commission must prevent waivers from effectively eviscerating the new rules and causing the loss of the potential benefits flowing from greater use of ECP principles. Here, the proposed 85 percent passthrough could play a role by serving as a floor for the waiver authority, not as a safe harbor. Thus, the Commission should add a requirement to Proposed rule § 3010.286(g) that no waiver should allow passthroughs of less than 85 percent of the avoided costs.

Finally, the *Revised NPRM* eliminated the proposal in Order No. 4258 to establish a “band” range above 100 percent. Instead, it in effect proposes to formalize the approach that the Commission currently applies to discount passthroughs in excess of 100 percent by requiring the Postal Service to reduce them gradually, and that should be adopted.[17]

## III. THE COMMISSION's PROPOSAL TO CREATE "SUPPLEMENTAL" AND "PERFORMANCE-BASED" RATE AUTHORITIES HAS FAILED TO CONSIDER OTHER OBJECTIVES AND FACTORS

In enacting Section 3622, Congress directed the Commission to design a system for regulating the rates of market-dominant products to achieve 9 statutory Objectives, "each of which shall be applied in conjunction with the others." 39 U.S.C.§3622(b). Congress further directed that in "establishing or revising" that system, the Commission also "shall take into account" 14 statutory Factors. 39 U.S.C. §3622(c). So the Objectives and Factors apply to the Commission's proposal to design a new system just as they did when the current rules were adopted.

The *Revised NPRM* does not heed this directive. Although the workshare proposal properly can be adopted on the basis of the Commission's undisputed legal authority, that is not the case for the rate authority proposals. Moreover, the failure to consider the effects of those new rate proposals on all of the Objectives and Factors – and not simply on the three Objectives that Order No. 4257 concluded were not met – violates the Commission's responsibility under the Administrative Procedure Act as well as of the PAEA. *See Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.,* 463 U.S. 29, 43 (1983) (agency acts arbitrarily when it entirely fails to consider an

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[17] *See* Proposed rule § 3010.283(c).

important issue); *Carlson v. Postal Regulatory Commission,* 938 F.3d at 343. Indeed, an agency "is not free to ignore any individual factor entirely." *Texas Oil & Gas Association v. Environmental Protection Agency*, 161 F.3d 923, 934 (5th Cir. 1998). Where, as here, a statute directs the agency to "take into account" factors, the Commission must give them attention. *Weyerhaeuser Co. v. Costle*, 590 F.2d 1011, 1046 (D.C. Cir. 1978).

Yet the *Revised NPRM* apparently assumes that the Objectives deemed achieved by the current system would continue to be achieved by the new system. But that assumption is unfounded generally, and it is certainly incorrect here given the magnitude of the proposed changes. In particular, the proposed new rate authorities would jeopardize the new system's ability to achieve Objectives 2, 6, and 8; and they could readily impair the system's achievement of, at least, Factors 1, 3, 4, 9, 12, and 13.[18]

Considering Objective 6 first, it is fair to question whether it is consistent with reducing administrative burdens and increasing transparency to add two complex adjustment formulas that produce unknown, unpredictable, and unlimited amounts, a TFP criterion, and still more reporting requirements. Compared to the straightforward simplicity of the current CPI price cap, the convoluted proposals in the *Revised NPRM* would take a substantial step in the wrong direction. The complexity and number of the different factors, and apparently numerous proceedings in which they would be evaluated, would make

[18] Factor 5, which directs the Commission to take into account the effect of worksharing on reducing postal costs, primarily pertains to the worksharing proposal.

it even more difficult to predict future rates, a problem that itself would accelerate diversion even if not reflected in formal price elasticities of demand.[19]

And Objective 2 (predictability and stability in rates) and Objective 8 (just and reasonable rates) are especially pertinent given that the *Revised NPRM* would allow the Postal Service to raise rates materially in excess of inflation. For example, the numerous new rate authorities that the Commission is proposing would greatly impair mailers' ability to predict prices over their planning periods.

The Commission also must take into account the Factors. Particularly relevant to this proceeding is Factor 1, which directs the Commission to take into account the value of the mail service actually provided, with value depending on both the actual service provided and the price for that service. Also, Factor 3 requires the Commission to consider the effect of rate increases on mailers, while Factor 4 directs the Commission to take into account any available alternative means to sending letters and other mail. Each of these Factors requires the Commission to consider how the potential rate increases – which exceed any past rate increases since enactment of the PAEA by well more than 100 percent -- could affect mailers and their volumes.

It is essential for the Commission to consider the effects on mailers because the *Revised NPRM* would step into the shoes of Congress by breaking the deal struck in the PAEA. In the PAEA, Congress allowed the Postal Service

[19] Large business mailers typically must make their postage plans some 6 to 7 months or even longer before their fiscal years begin. Today, they can estimate CPI with some accuracy, but the additional factors (and how the Governors might use them) would complicate this task immensely. This would compel mailers to accelerate shifting to more predicable alternatives.

greater operational and pricing flexibility and reduced regulation in competitive markets, while assuring mailers subject to the postal monopoly that overall rates would stay within inflation.

In the *Revised NPRM*, however, the Commission proposes to abrogate that bargain to the detriment of mailers. The *Revised NPRM* would jettison the price cap by tacking on a "density" factor that will only spiral upward and calling for other changes that cumulatively would allow annual rate increases to skyrocket above inflation by, at a minimum, 5 percent annually, and potentially by an unlimited amount because there is no ceiling on the allowable increases.[20] This undermines the predictability and stability of rates, which under the proposed system could change annually anywhere from no change to 5 or more percent above CPI (and the CPI cap authority would remain available to the Service as well). And it undermines the justness and reasonableness of rates by laying the framework for unlimited rate increases.

This is occurring because the Commission's primary focus is on "solving" its flawed interpretation of financial stability adopted in Order No. 4257 by throwing more postal customers' money at the Postal Service regardless of the effect on mail volumes, cost reductions, or incentives for efficiency (as required by Objective 1). To the extent that the *Revised NPRM* would authorize additional revenues intended to advance Objective 5, it would come at the cost of accelerated volume declines that in turn automatically would justify, under the

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[20] In practice, the new system would resemble the cost-of-service regulatory system that prevailed under the former law – in which the Postal Service could simply raise rates to recover all of its costs -- but with far fewer customer protections.

density and retirement proposals, even higher rates. Those higher rates would, in turn, drive even more mail out of the system and threaten to trigger the long-feared death spiral.

Yet the Commission has made no attempt to estimate how much mail would be driven away by the higher prices that Order No. 5337 proposes to allow. This is where price elasticity estimates serve a purpose. But the Postal Service's price elasticity estimates are of doubtful accuracy because, due to the cap, real rates at the class level and, generally, at the product level have not substantially changed since the PAEA took effect.[21] Accordingly, it is unknown whether the Service's volume forecasting model provides accurate elasticity estimates when applied to rate changes well outside the ranges seen over the past decade. We do know that the 4.3 percent exigency surcharge set in motion large declines in First-Class Mail volume, which due to the lag effect fell by more than 4 percent in FY2017 after the exigent surcharge was removed.[22] Large business mailers have been reducing their use of mail for years in favor of less

[21] That is to be expected under an inflation-based cap regime. When rates change with inflation, there is no real price change, so there is little basis for forecasting the effects of a real price change. The Commission only a few years ago declined to undertake an update of the price elasticities that could have taken current mailer price sensitivities into account. *See* Order No. 3100, *Price Elasticities and Internet Diversion,* Docket No. RM2014-5 (Feb. 26, 2016) (Order Closing Docket).

[22] Although the surcharge expired before mailers had fully implemented strategies to reduce mail use due to the higher rates, those strategies – once set in place – continued and, over time, took hold. This was seen in FY2017, when the Postal Service began to be surprised by volume reductions that it had not forecasted. It was not forecasted only by the models, because mailers had warned the Postal Service and the Commission that such was the likely outcome of the exigency approach to reimburse the Service for recession-based business losses when the customers themselves had no means to recoup their own recession-based losses. We note that First-Class Presort volumes have never recovered from the reductions mailers felt compelled to implement due to the exigent surcharge.

costly, more predictable, and easier-to-use alternatives.[23] Without the protection of the price cap, mailers will face potentially unlimited rate increases that would undoubtedly accelerate recent volume trends.

Today, the price cap provides an ongoing rigorous incentive for the Postal Service to work persistently to control costs.[24] The *Revised NPRM* would thoroughly undermine that incentive by creating multiple exceptions and by replacing the strong cost-reducing effect of a firm price cap with toothless reporting requirements. *RNPRM* at 15 (stating the Commission proposes to protect mailers by holding the Postal Service "accountable for reporting on its efforts to reduce costs within its control"). Would fans at a hockey game be reassured if the protective walls around the rink were removed and replaced with a requirement that the home team annually file an after-the-fact report three months after the season ends on how many times a puck flew into the seats and injured someone? However laudable the goal, still more reporting requirements are in tension with Objective 6's goal of minimizing administrative burdens.

The proposals to allow the Postal Service to raise rates beyond the statutory CPI limit takes none of these Objectives and Factors into account. The

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[23] Where an entity's volume and market share decline because of new entrants or new technologies, the solution is not to raise prices on what remains. The solution is to make the entity's mousetrap easier to use and offer a lower price. The entity can raise rates successfully only if it builds a better mousetrap. But here, the Postal Service has been raising prices while *degrading* its mousetrap via reduced service. That is old school monopolistic thinking. In 2019, the Postal Service retains its monopoly only with respect to certain paper communications. Mailers that have been asked for years to pay more for less are looking for other mousetraps.

[24] The Northwest Postal Consulting report cited by the Commission notes that the price cap "did appear to have indirect influence on the Underlying Factors and the control of resources to match work content" as well as influenced the outcome of the labor contract negotiations. *Comparison of Postal Service Productivity Measurement: Before and After PAEA Enactment*, at 87 (Mar. 27, 2017) (Final Report).

failure to take relevant considerations mandated by the statute into account is contrary to reasoned decisionmaking.

## IV. THE PROPOSED "DENSITY RATE AUTHORITY" IGNORES THE POSTAL SERVICE's ABILITY TO MANAGE COSTS, PRODUCES EXCESSIVE RESULTS COMPARED TO THE ESTABLISHED METHODOLOGY, AND WOULD CREATE THE LONG-FEARED DEATH SPIRAL

The *Revised NPRM* proposes to give the Postal Service "supplemental" rate authority in excess of the statutory price cap to recover "lost" unit contribution per delivery point due to declines in volume. *RNPRM* at 70.[25] This so-called "density" factor would consist of a formula that multiplies the ratio of institutional costs to attributable costs by the year-over-year change in pieces delivered per delivery point (density). *RNPRM* at 71-72.[26] Any conferred density rate authority would lapse if unused within 12 months after being authorized and could not be used to generate unused rate authority or affect banked rate authority. Proposed rule § 3010.160(c)(3) & (4).

Perhaps because the proposed density rate adjustment treats the Postal Service's greatest asset as a problem, it should not come as a surprise that the proposal has many flaws. In particular:

- It treats as "uncontrollable" costs that in fact the Postal Service has ability to control – although it certainly must do more -- because

[25] Unlike the proposals in Order No. 4258, this proposal does require Competitive products to participate in the calculation of the amount to be charged in higher rates, which is a necessary improvement.

[26] The density rate authority would be calculated twice, once using the change in density based on total volume and, separately, using the change in density based on market-dominant volume alone. The lower authority would be the one used.

delivery costs, easily the largest source of network-related institutional costs, are declining;

- The formula bears no relation to the actual costs of additional delivery points or density decline as determined by the well-established roll-forward model;
- The density formula has no relation to actual postal costs or revenues, and ignores the evolution of the mail mix to higher contribution pieces;
- It would weaken the financial incentive for the Postal Service to reduce delivery costs, and create a perverse incentive to increase them;
- The formula sets up the long-feared death spiral of rates increasing steadily faster the more that volume declines;
- If adopted, it should be modified to *reduce* rate authority going forward if per unit delivery costs decline; and
- If adopted, the Commission should exclude volume losses as a justification for an exigency request.

### A. The Density Formula Addresses An Illusory "Problem" Because Network Costs Are Not Unavoidable

The density rate adjustment is proposed to address a problem that does not exist. The proposal is rooted in the notion that as volume declines and delivery points increase, there are fewer pieces to cover "uncontrollable" non-volume variable network costs. *RNPRM* at 75. But those costs are not, in fact, uncontrollable.[27]

Quite the contrary, the Postal Service has substantial ability to manage and reduce such costs. Indeed, the Postal Service spoke with pride recently that it has "implemented aggressive cost controls that have resulted in significant cost

[27] Although the Commission says that "density" is outside of the Postal Service's control *(RNPRM* at 77), the Postal Service has significant ability to affect and control costs per delivery point both directly and indirectly through its pricing decisions that affect volumes.

savings even as delivery points grew by over 9 million" in the past decade.[28] This shows that delivery costs are not uncontrollable, although the Postal Service must continually strive to control them more effectively.

City and rural carrier delivery costs (the physical embodiment of the delivery network) are disproportionately classified as institutional costs while far greater shares of mail processing and transportation are attributed. But the Postal Service has demonstrated an ability to reduce delivery costs since the PAEA and its price cap took effect. From 2007 through 2019, the *institutional* costs of city and rural delivery – which the formula seeks to recover -- have *declined*, in inflation-adjusted dollars, by a total of $990,774,000. *See* Attachment 1. The Postal Service *reduced* these "uncontrollable" costs while the number of delivery points *increased*. As a consequence, the institutional cost per delivery point has increased by less than inflation (17.3 percent cost increase compared to 23.9 percent inflation) over that time. *See* Attachment 2.

What accounts for these cost reductions? First, as the GAO independently has found, the Postal Service has substantial ability to manage the delivery cost component of delivery costs, contrary to the premise of the delivery

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[28] *USPS Strategic Plan*, at 11. It should be recalled that prompting this kind of cost discipline, unprecedented for the Postal Service, was a key reason that PAEA established the CPI-U price cap. Adopting the *Revised NPRM*'s proposals would attenuate the cap to the point of evisceration and would return to the pre-PAEA experience of simply raising rates in reaction to losses. Unlike in the pre-PAEA era, however, customers now have well-established alternatives which have already badly damaged postal volumes, and mailers readily will pursue those alternatives even more vigorously.

rate adjustment.[29] Newer delivery points cost less than older ones. The Postal Service's preferred practice nowadays is to require, wherever possible, centralized delivery receptacles, such as cluster boxes, which have lower unit costs than other delivery means.[30] As CBUs continue to become a larger share of the number of receptacles, the average delivery cost will continue to fall. The GAO noted a Postal Service estimate of potential ongoing annual savings exceeding $2 billion if 12.2 million door delivery points were converted over 10 years to CBU and curbline delivery. *GAO Report* at 12. And it is quite possible that innovative technologies based on Intelligent Mail barcodes and artificial intelligence could do still more to reduce delivery costs.[31] At the least, the new data generated by IMBs should enable the Postal Service to improve its performance.

Second, the Postal Service has reconfigured delivery routes to become more efficient. This has allowed it to use lower-cost staff, instead of carriers, to sort mail. In part this is related to the conversion of type of delivery receptacles, but it is partly a response to changes in volume and mail mix. Over time, these have led to positive results.

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[29] *See* Government Accountability Office, *U.S. Postal Service: Delivery Mode Conversions Could Yield Large Savings, but More Current Data Are Needed,* GAO-14-444 (May 2014) ("*GAO Report*").

[30] *Postal Operations Manual* §351.242 (stating that new business addresses must receive centralized delivery unless the Postal Service approves an exception and encouraging curbline or CBU delivery for new residential delivery.

[31] The Postal Service should also explore current and new technology, such as unmanned vehicles and robotics, that could deliver mail to the curb.

Third, the Postal Service itself certainly has no trouble identifying still more steps it plans to take to better manage the costs of its network. For example, its recent Annual Report to Congress identified several actions it has taken, or plans to take, to improve the processing and transportation aspects of its network.[32] These should be given an opportunity to succeed before drastic rate measures are approved. Indeed, giving the Postal Service more rate authority would likely undermine its incentive to implement these plans.

Although the Postal Service almost certainly could do more, such as making more prudent use of carrier hours to reduce overtime and penalty overtime costs,[33] the premise that delivery costs are uncontrollable is plainly not correct.

Nor is the Postal Service helpless to affect volume. For example, with its existing authority it could reduce prices, offer more economically efficient prices, simplify mailing requirements, actually provide the service promised in its service standards, and create its touted public-private partnerships by offering innovative services and negotiated services agreements. The recently released Strategic Plan anticipates "significant revenues from offering digital and other value-added features that enhance the value of our physical delivery network."[34] These

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32 *USPS FY2019 Annual Report to Congress*, at 22-23.

33 The Office of the Inspector General reports that overtime exceeded plan from FY2013 to FY2018 by 29 million hours, and overtime and penalty overtime costs in delivery alone rose $327 million during that time. *See Assessment of the U.S. Postal Service's Service Performance and Costs*, Report No. NO-AR-19-008, at 3 & 17 (Sept. 17, 2019).

34 *USPS Strategic Plan,* at 17. The Service also plans to make greater use of the Informed Delivery platform to integrate a range of digital services. *Id.*, at 18.

actions, some of which it has not tried, all could increase volume to offset declines in density. The Commission should give the Postal Service's new leadership a chance to implement these plans before driving mailers away by authorizing higher rates.

For these reasons, the concern that underlies the proposed density factor is overstated. The Postal Service has many tools available to it today with which it can affect costs and volumes, and these – including more efficient pricing -- should be tried before more drastic and legally dubious measures are taken.

### B. The Density Rate Adjustment Formula Would Produce Wildly Excessive Results When Compared To The Established Rollforward Methodology For Estimating Delivery Costs

When devising a formula to enable the Postal Service to recover network-related cost contribution purportedly lost to declining density, a reasonable step would be to compare the results of such a new untested approach with established methodologies that quantify density-related network costs. This the Commission has not done. If it had, it would have discovered that the density formula would substantially over-recover non-volume variable costs.

The proposed density formula is intended to measure the lower unit institutional cost contribution arising from lower density per delivery stop. The formula multiplies the ratio of systemwide institutional costs to total costs by the percentage change in the number of delivery points over a given year. Using the *Revised NPRM*'s hypothetical at Table IV-3, this could result in additional rate authority ranging widely from $180,000,000 to $1.345 billion.[35] Under the proposals, those numbers purport to represent the amount needed to "recover" the contribution to network costs lost due to density declines in those years.

Projecting the density formula forward produces similar outcomes. The Postal Service's recently released Five Year Strategic Plan projects an 18 percent decline in volume through FY2024. *USPS Strategic Plan*, at 15. It also projects a 5 percent increase in the number of delivery points over the same period. *Id*. Assuming that the number of delivery points increases at a linear rate, that produces a cumulative 10.76 percent increase in rate authority from the density formula alone in five years.[36]

Although the density rate adjustment is intended to offset higher delivery costs stemming from declining volume per delivery point, the proposed formula notably *does not use actual delivery costs*. This omission is particularly striking because there exists a well-established and tested methodology for forecasting delivery costs that the Commission has and approved and used many times and that uses delivery points as an input. That is the Postal Service's rollforward model, which starts with known costs for the most recent year and forecasts costs for a future year, taking into account all expected changes in cost inputs driven by the operational need to serve more delivery points or to manage changes in volume.

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35 This assumes market-dominant revenue of $50 billion and uses the rate authorities hypothetically authorized in FY2013 and FY2017. The amount for FY2019 would be approximately $562 million, using the market dominant revenues reported in the ACR for FY2018 and the 1.21 percent in Table IV-3.

36 *See* Attachment 3.

The Postal Service's rollforward model was last used publicly in Docket No. R2013-11. By using that model, one can calculate the average cost of a new delivery point– holding volume constant – by comparing the average cost of a delivery point in a given year Y (here, 2013) with that of Y-1 (here, 2012). That cost, in FY2013, came to $101 per delivery point (723,310 new delivery points, at an incremental rollforward cost of $73,370,016).[37] Using that value and adjusting for the additional 1.34 million delivery points that were added in FY2019,[38] the non-volume effect (as volume is held constant, variable costs do not change) for the additional delivery points comes to about $136 million.

Compare that to the proposed density formula. Institutional costs comprised 43.93 percent of all costs in FY2019 and the number of delivery points increased by about 1.34 million, or 0.8 percent.[39] Holding volume constant, the density authority would be 0.37 percent. Applied to FY2019 total actual revenue, that would produce about $259 million in density authority. Because volume is held constant here also, this calculation produces the proposed formula's "unavoidable" cost increase due to lower density resulting only from more delivery points (because the constant volume is spread across more delivery points) – in other words, the non-volume variable cost of the additional delivery points.

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[37] Although inflation may have increased this cost slightly, the changes described in the preceding section should have reduced the cost. In the absence of more current Postal Service data, that is a reasonable estimate of the cost of a new delivery point.

[38] *See USPS FY19 Annual Report to Congress*, at 14.

[39] *See USPS FY19 Annual Report to Congress,* at 14.

However, applying the density formula results in *nearly double the amount of the rollforward costs of additional delivery points as calculated using the established rollforward methodology* at constant volumes. And if the formula does not produce realistic numbers in the simple "bounding" case at constant volumes, there is absolutely no reason to think it would be accurate for non-constant volumes. This fact discredits the proposed formula.

At the least, the Commission must consider and explain why its new proposal results in a non-volume variable cost that diverges so materially – by nearly $123 million – from the result of the rollforward model upon which the Commission and Service have both relied heavily in the past. An agency must be aware when it changes a position and may not diverge from precedent without an explanation. *Federal Communications Commission v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (agency must provide detailed justification when "new policy rests upon factual finds that contradict those which underlay its prior policy"); *Southwestern Airlines Co. v. Federal Energy Regulatory Commission*, 925 F.3d 851 (D.C. Cir. 2019); *Greater Boston Television Corp. v. Federal Communications Commission*, 444 F.2d 841, 852 (D.C. Cir. 1970).

It is unsurprising that the density formula might lead to rate authority far in excess of carefully calculated costs because *it ignores both actual costs and revenues*. The formula produces the same factor whether the Postal Service's revenue is $60 billion, $60 million or $600,000. Consequently, it is invariant to the real-world consequences of its outcome. But there is certainly no *prima facie* reason to expect that a formula intended to calculate lost unit contribution to non-volume variable costs when volume falls -- but that does not use cost or revenue in doing so -- would produce a reasonably accurate result.[40]

Another critical shortcoming in the density formula is that it does not take into account changes in the composition of the mailstream. Mail that makes larger unit contributions (First-Class Presort Mail and packages) now comprises a larger portion of the mailstream than in previous years.[41] In FY2010, Competitive mail comprised 0.8 percent of total mail volume; in FY2019, that percentage increased by 500 percent to nearly 4 percent of total mail volume.[42] And the composition of the First-Class letter mailstream has become less lower-contribution Single-Piece and more higher-contribution Presort mail. Put differently, the Postal Service currently earns more contribution per average piece in the mailbox than in years past. The density formula simply uses a system average institutional cost ratio that ignores how the unit contributions vary widely among types of mail. It does not take into any account the relative unit contribution from the volume that has left the system compared to that which remains.

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[40] This is because Competitive products have soared as First-Class Single-Piece letter volume has declined. The Commission's formula would include *all* volume declines in the density factor calculations, not merely those due to so-called "exogenous" factors. *RNPRM* at 75. The *Revised NPRM* (at 75) states that estimating non-price induced volume change would be "extraordinarily difficult." But that necessarily would over-recover for the effects of density declines alone.

[41] Presort letter volume is declining less quickly than Single Piece, and packages make much larger unit contributions than market dominant mail. Also, the continued decline in Periodicals volume removes negative contribution pieces from the mix.

[42] *Compare* Docket No. ACR20120, *USPS-FY10-1, fy10publiccra.xls with* Docket No. ACR2019, *USPS-FY19-1, Public_FY10CRAReportRev.1.10.2020.xlsx.*

As proposed, the density formula would authorize the Postal Service to recover far more than the costs of delivery as determined by the well-established roll-forward model and does not take relevant factors into account. It must not be adopted.

### C. The "Density Formula" Would Conflict With Objective 1 By Reversing The Postal Service's Current Incentive To Reduce Costs

The *Revised NPRM* states that by basing authority on "unavoidable increases in unit costs," the density factor "maintains the efficiency incentives created by a price cap." *RNPRM* at 76. This is unlikely to be true. It is more likely that by eviscerating the price cap by amounts likely well above CPI, the density factor would reduce the Postal Service's current (and successful, as shown in Section A above) incentive to reduce delivery costs, the largest component of "unavoidable" network costs.

*Nothing* about the density factor would incentivize the Postal Service to reduce the unit cost of delivery costs or make delivery more efficient. The only inputs to the formula are volumes, delivery points, and the ratio of institutional to total costs. Neither the costs of the network nor of delivery points nor any other cost plays any role in the formula.

In fact, the greater the proportion of total costs that institutional costs become, the more money the Postal Service would be entitled to receive. Comforted by the assurance that rates automatically could rise to recover all costs,[43] the Postal Service would have no incentive to maximize cost reduction and efficiency and would have an incentive to reduce attribution levels. It also would have less incentive to take innovative steps to increase volume.

### D. The Density Formula Would Create A Death Spiral

If adopted, the density rate authority would establish in postal rate regulation the formula for the long-feared death spiral. The formula ensures that the faster volume falls, the higher rates will go. Nothing will undermine the Postal Service's financial stability more than accelerating volume losses.

This dark scenario follows directly from the formula. Using the example at Tables IV-1 and IV-2 of the *Revised NPRM*, if in a given year the Postal Service's network obtains greater value by adding delivery points, but its offerings are less attractive to mailers so that volume falls, it nonetheless receives authority to raise rates on the dwindling number of captive mailers by at least an additional 1.19 percent above inflation.[44]

Recognize also that there is no ceiling on this authority. If volume were to fall even faster, the density rate authority would increase correspondingly with no limit. In Table IV-3, the Commission estimates what density rate authority would

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[43] The creation of a special factor devoted to recouping delivery costs comes very close to a form of Fully Distributed Costing, which the Commission has rejected economically unsound on several occasions. It also would mark a return to the mindset of cost-of-service ratesetting under the former Postal Reorganization Act. In this way, it would gut some of the central tenets of the PAEA, and the commitment that law made to stakeholders and the public.

[44] The First-Class Business Mailers appreciate that the proposed formula would allow market-dominant mail to benefit from growth in Competitive volume. *RNPRM* at 74. This is a necessary improvement over the previous Phase II proposals, which had placed the entire burden of higher rates on market-dominant mailers.

have been generated had its formula been in place since 2013. The average is 1.23 percent per year, with noticeable and unpredictable variation. However, in years in which postal volumes fell substantially, the density adjustment would have awarded the Postal Service the largest authority. For example, had the density factor been in effect in FY2009 in the midst of the Great Recession, it would have authorized an increase of 5.38 percent.[45] A 2.69 percent authority would have been authorized in FY2013 based on FY2011 and FY2012, illustrating the wide and unstable variations that the formula would produce.

Creating an automatic formula for a death spiral would not "stabilize" the Postal Service's finances. Instead, the density adjustment would, however improbably, impose the largest rate increases on mailers in the year after the Postal Service experiences relatively larger volume declines. That, in turn, would accelerate further declines through the price elasticity effect, and the spiral would continue. This could not serve either the immediate or long-term interests of either mailers or the Postal Service.

Curiously, the proposed density rate adjustment conceptually it treats the Postal Service's universal service obligation and nationwide delivery network as a cost problem rather than as a valuable business asset that increases in value as it grows through network effects.[46] Of course, the Postal Service is vulnerable

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[45] Data underlying this calculation are from FY2008_RPWsummaryreport_Public.xls, "FY2008", cell L78 + cell L134 (Feb. 2, 2009); FY2009_RPWsummarreport_public.xls, FY2009 Public, cell L193 (Nov. 20, 2009); USPS Annual Tables, FY2018 TFP (Total Factor Productivity), table annual 2018 - 2018 cra public.xlsx, "Out-46"; & USPS-FY-09-1, FY09publiccra.rev.12.30.09.xls, "Cost3".

[46] Growth in the delivery network should be encouraged because it expands the Postal Service's competitive advantage, not treated as a burdensome cost. The Postal Service

to volume declines;[47] so is any business. But, like any other business seeking a turnaround in the face of falling volumes, its task is to manage costs and seek new revenue by becoming more customer-centric, including increasing volumes through price reductions and removing obstacles to using the mail.

### E. The Rationale For The Density Formula Would Require Reducing Supplemental Rate Authority If Density Increases

If density increases, the Postal Service's cost per delivery point should decline, for exactly the converse of why that cost increases if volume falls. The additional volume allows the "uncontrollable" network costs to be spread among more pieces, lowering the per unit cost.

Yet the proposed density formula does not take this into account – it is only a one-way ratchet in favor of raising rates. If density or volume were to increase, making the adjustment negative, the density factor would result in no change in rate authority; there would be no reduction. Proposed rule § 3101.162(b)(2). And the Postal Service would retain all density authority acquired in previous years. But if the Postal Service is awarded additional rate authority for exogenous volume decreases in order to cover "fixed" or unit costs per delivery point, by the same reasoning its rate authority should be reduced by the same formula if volume increases and contributes more to cover delivery costs.

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understands the value of its "unparalleled physical and digital infrastructure." *USPS Strategic Plan*, at 24.

[47] *E.g., RNPRM* at 65, *citing USPS 2017 Comments,* at 99.

It is no answer to say that an increase in density per delivery point is unlikely. If that were so, there would be no "harm" in modifying the rule to provide for reductions if that purportedly unlikely event comes to pass. The only reason for eschewing that change would be to allow the Postal Service to maintain higher rates regardless of density. Because the *Revised NPRM* premises this authority on density, but makes no effort to justify the failure to reduce density authority when unit costs fall, the proposed formula is arbitrary.

### F. If The Proposed Density Formula Is Adopted, The Commission Should Exclude Volume Losses As A Possible Justification For An Exigency Request

The proposed density formula would award the Postal Service additional rate authority if volume declines. The theory is that the Service needs extra contribution per remaining piece to cover non-volume variable delivery point costs. If the Commission adopts this proposal, it should simultaneously state that volume losses could not serve as justification for any subsequent exigency case under 39 U.S.C. §3622(d)(2).

In Docket No. R2013-11, the Postal Service sought, and after modifications by the Commission received, authority to collect an exigent surcharge for volume losses due to the 2008-2009 recession. Order No. 1926 (Dec. 24, 2013). Adoption of the density formula should remove such volume declines as the basis for any future exigency request, because the formula is intended to "compensate" the Postal Service directly as volume declines.

## V. THE PROPOSED RETIREE OBLIGATION RATE AUTHORITY IS EXCESSIVE, HAS NO EFFECT ON THE POSTAL SERVICE'S ABILITY TO MAINTAIN AND DEVELOP POSTAL SERVICES, AND PROMISES UNLIMITED INCREASES THAT WOULD ACCELERATE AS VOLUME DECLINES

In the PAEA, Congress required the Postal Service to fund the unfunded portions of retiree health benefits, Civil Service Retirement System liabilities, and Federal Employees Retirement System liabilities. The amounts of these amortized payments are set annually by the Office of Personnel Management. The Postal Service treats the "normal" costs as a labor cost and attributes them to products in proportion to total labor costs. *Revised NPRM* at 90. It treats the amortized payments as institutional costs because the amounts are set by an OMB schedule, not driven by volume and labor costs.

For FY2019, the required (but unpaid) amortization payments were:

RHB: $ 0.8 billion
CSRS: $ 1.617 billion
FERS: $ 1.060 billion.

*USPS Form 10K,* at 27 & 34. The Postal Service has not made the prefunding payments into the retiree health benefit fund since FY2011, nor has it made the CSRS or FERS payments since FY2017 and FY2013, respectively. The Commission must take into account that the Postal Service has suffered no consequences for missing these payments.

These unpaid amounts as an accounting matter are classified as liabilities on its balance sheet. This is by far the largest contributor to the Postal Service's accounting net losses.[48] This also paints a misleading picture, because the

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[48] *USPS Strategic Plan*, at 12.

Postal Service's operational finances are in much better shape. And the Commission cannot ignore the substantial market value of the Postal Service's real estate holdings and the current retirement funds.[49] *Genuine Parts Co. v. Environmental Protection Agency*, 890 F.3d 304, 312 (D.C. Cir. 2018) (stating that "an agency cannot ignore evidence that undercuts its judgment").

Although the prefunding obligation is truly a matter that only Congress can fix, the Commission proposes to create supplemental authority – entirely outside of the price cap – to allow the Postal Service to raise rates to collect funds to make these payments. The proposed supplemental rate authority would take the form of a surcharge based on the amount by which revenue would need to increase to make the full amortized payment set by OPM each year. Expressed as a percentage, this would be phased-in over five years, adjusted each year to account for the compounded value of increases already factored in. *Revised NPRM* at 91-92.[50] After the five-year phase-in period, the total accumulated surcharges would thereafter remain permanently in the rate base.

The Commission would recalculate the retirement rate authority each year as a percentage of the previous fiscal year's total revenue. There is no set

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[49] The Postal Service has substantial real estate assets that appear on its balance sheet at net depreciated value. The net value of its property and equipment as of September 30, 2018, was $14.6 billion. *USPS 2018 Form 10-K* at 16. That figure is indisputably far below the true market value of those properties. Although the Postal Service has not provided the market value of its real estate, a few years ago its Inspector General has estimated that the market value of Postal Service real estate could be as high as $85 billion. Office of the Inspector General, *Considerations in Structuring Estimated Liabilities*, Report No. FY-WP-15-003, at 3 (Jan. 23, 2015). The Postal Service also has more than $335 billion in its FERS, CSRS, and RHB funds. *USPS FY18 Integrated Financial Plan* at 5.

[50] The phase-in in years 2 through 5 would be adjusted to offset the compounding of such retiree rate authority awarded in previous years. *RNPRM* at 92.

amount to the authority, which would fluctuate depending upon postal revenues and the OPM.[51] Nor is there any limit to the amount of the increase either annually or cumulatively, and a substantial drop in Postal Service revenues could increase the surcharge substantially.

Raising rates by the full amount of the supplemental retiree rate authority effectively would be mandatory, or else the Postal Service would forfeit the authority granted in that year. *See* Proposed rule § 3010.185(c).[52] Only if the Postal Service does not raise rates by the full amount within 12 months of receiving authority from the Commission (Proposed rules § 3010.181(c) & § 3010.185(c)) or if it fails to remit to the Treasury the entirety of the collected funds for the required prefunding payments (Proposed rule § 3010.185(d)), would it receive no more supplemental authority. However, the Commission would allow the Postal Service to continue to collect on the basis of the additional authority awarded to that point.

But even if the Postal Service fails to remit the collected money to the Treasury, the Commission would allow it to retain permanently all of the compounded retirement rate authority granted to that point That would simply

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51 An example offered in the *RNPRM* (at 92) assumes that the percentage increase required in each of the first two years is five percent. That illustration results in an annual increment of 1 percent authority (before the compounding adjustment). However, this number would change with changes in postal revenues and OPM amortization calculations. For example, even in the relatively stable case where revenues were to fall by 2 percent and the OPM calculation rise to $3.2 billion, the additional rate authority would be materially above 1 percent.

52 Proposed § 3010.185(c) requires the Postal Service to file for a rate increase including "the full amount of retirement obligation rate authority" else risk losing its future eligibility for such rate authority. This appears to leave the Postal Service Governors with little discretion to request a smaller amount if, in their judgment, doing so would more appropriately balance the interests of the Service with those of mailers.

repeat and compound the Postal Service's current failure to remit the $3.1 billion already in the rate base since Docket No. R2005-1, and do nothing to "solve" the "problem" that purportedly justified the authority in the first place.

### A. The Proposal Attempts To Address A Problem That Only Congress Can Address

All parties that have addressed the retiree prefunding obligations in this proceeding have recognized that the most appropriate way to address this accounting issue is for Congress to repeal the retiree prefunding requirement.[53] The Commission itself has recommended that Congress do so numerous times.

Nevertheless, instead of deferring to Congress, the Commission would now authorize dramatically higher rates that could cause permanent harm to the Postal Service. Postal volumes have declined steadily since 2006, and the proposal to allow the Postal Service to raise rates beyond inflation will surely accelerate those declines.

The Commission has no statutory role in creating requirements about how the Postal Service should pay its liabilities. Moreover, given the potentially drastic consequences of these proposals on the mailing community and on future postal volumes, as a prudential matter the Commission should let Congress determine if such a profoundly impactful course of action is in the national interest. Finally, if Congress enacts legislation to repeal the prefunding requirement in part or in whole, the corresponding supplemental rate authority

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[53] The Postal Service's recent strategic plan states that the prefunding obligations for retiree health benefits, CSRS, and FERS accounts for about 84 percent of its cumulative net accounting losses since 2007. *USPS Strategic Plan,* at 12.

generated pursuant to this proposal should immediately be removed from the rate base.

### B. The Proposal Should Be Adjusted To Take Into Account The $3.1 Billion Per Year For Retiree Benefits Already In The Rate Base

The *Revised NPRM* ignores that the Postal Service has collected $3.1 billion from mailers towards its retiree benefits every year since Docket No. R2005-1. In that case, a settlement agreement resulted in a surcharge that, at that time, was intended to fund an escrow related to the CSRS. *See Opinion and Recommended Decision*, Docket No. R2005-1, at ¶3001 *et seq*. (Nov. 1, 2005). That case was settled for that specific purpose, and that increase became a permanent part of the rate base and has never been rescinded. That original $3.1 billion has continued to grow in the years since with the CPI.

In the PAEA, Congress redirected those escrowed funds to be a partial prepayment of the retiree health benefit premiums. PAEA, Section 801, 5 U.S.C. §8348(h); *see also 2011 Section 701 Report*, at 16. By directing those funds towards payment of retiree health benefit premiums and not authorizing an exogenous charge to recover them, Congress necessarily determined that these payments were internal costs to the Postal Service. Accordingly, the *Revised NPRM*'s proposal to treat those costs as essentially "exogenous" – as somehow outside of the system and appropriate for a surcharge outside of the price cap – cannot be squared with Congress's decision to include them as endogenous costs.

Because of PAEA, the $3.1 billion has remained in the rate base to fund the prepayment obligation and the Postal Service has continued to collect it. Mailers have now paid a cumulative amount in excess of $39 billion over the years for this purpose. However, the Postal Service stopped making those payments in Fiscal Year 2012. Unfortunately, because there was never a dedicated account for that money, there is no way to tell how the Service spent it.

Today, that $3.1 billion amount (which now has increased due to inflation) would cover most of the amortized payments due. *USPS Form 10K,* at 27 & 34 (summing CSRS, FERS, and PSRHBF amortization payments to $3.477 billion). Before the Commission invents additional rate authority to cover retiree payments required under the law, but unpaid with no consequences for years, it should require the Postal Service to account for that money.[54] If the Commission finds that the Postal Service spent it on other purposes, then no additional authority would be appropriate for the reasons set forth in the *Revised NPRM* itself at 95.

This history of diverted payments is particularly striking in light of the Commission's proposal that a failure by the Postal Service to make the prefunding payments would cause it to lose further authority going forward. Under the proposal, the Postal Service could continue to include any supplemental retiree rate increases given in past years in its rate base going

[54] Nothing prevented the Postal Service from separately accounting for these funds from the time they were first authorized until it stopped making the payments, but as far as we are aware it did not do so. The Service should have segregated the funds then, it should be doing so now, and it should do so with any additional collection authority that the Commission might adopt.

forward. That, in fact, is precisely what the Postal Service has done with the original $3.1 billion.

The lesson is that such authority, once given, must be removed if the funds are not remitted as intended. Otherwise, all that has happened is that the Postal Service, after making a prefunding payment for a year or two, can simply stop the payments but keep the money – just as it has done with the $3.1 billion.

### C. Additional Rate Authority To Make Amortization Payments Would Have No Effect On The Postal Service's Financial Stability

The underlying premise of the *Revised NPRM* is that additional funds are required to help the Postal Service meet the Commission's definition of "financial stability" under Objective 5. *E.g., RNPRM* at 12-13 & 91. The *Revised NPRM* hopes that the retirement obligations surcharge would help the Postal Service achieve the Commission's self-created concept of "medium-term" stability, defined as revenue exceeding the sum of attributable and institutional costs, by creating a separate targeting revenue stream to fund the amortized payments.

This is unnecessary. The retirement rate authority is intended to fund prepayment obligations that the Postal Service has not made for nearly a decade. And the Postal Service has experienced no adverse consequences for that failure; indeed, presumably it benefitted from spending that money on operations over that period. The proposed rate authority would add no money to support operations; instead, the *Revised NPRM* intends for every penny to go to the Treasury.

As the First-Class Business Mailers have explained previously, the Commission's construct of "financial stability" has no basis in the statute. A statutorily-based definition of financial stability, taken from Section 3622(d), is that the Postal Service shall earn sufficient revenue to enable the Postal Service, "under best practices of honest efficient and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." *First-Class Business Mailers Phase II Comments*, at 48-50. Both the Commission and the Court of Appeals have called the exigency provision a "safety valve" that allows the Postal Service to "compensate[] for the net adverse financial impact of the exigent circumstances." Order No. 864, Docket No. R2010-4R, at 25 (Sept. 20, 2011); *Alliance of Nonprofit Mailers v. Postal Regulatory Commission*, 790 F.3d 186, 189 (D.C. Cir. 2015).

How extracting money from mailers for delivery to the Treasury helps in any relevant or meaningful way the Postal Service to "maintain and continue to develop" services is unexplained. The *Revised NPRM* says that this supplemental authority will allow the Postal Service "to liquidate its unfunded retirement liabilities" and "improve its financial health," presumably doing the latter by reducing the unfunded prepayment liabilities shown on its balance sheet. *RNPRM* at 91. However, even at 5 percent per year, which if applied to FY2019 market dominant revenues of $43.884 billion[55] results in $2.19 billion of additional authority, fulfilling the prepayment obligation would take decades.

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[55] Docket No. ACR2019, *USPS Pubic FY19-1 CRA Expanded* Tab Summary.

Any prepayments, of course, would go directly to the Treasury. They would not fund postal operations. Nothing about them helps the Postal Service "maintain and continue the development of postal services" needed by the nation, much less deliver even a single piece of mail. Instead, the payments would merely address an internal government accounting measure.

Accordingly, not only does the Commission lack the legal authority to allow the Postal Service to exceed the CPI price cap (as discussed at length in the *First-Class Business Mailers Phase II Comments*), but the proposed supplemental rate authority in particular also cannot be justified by "financial stability" in Objective 5.

### D. The Accumulated Rate Authority Would Impose Potentially Unlimited Rate Increases On What Market-Dominant Mail Remains

The *Revised NPRM* proposes to recalculate the retirement rate authority each year, which it says would account for volume changes during the phase-in period: "If volume declines, the full amortization payment will represent a greater proportion of total revenue, and the proposed formula will provide additional retirement rate authority." *Revised NPRM* at 92. Put simply, as volume falls, rate authority would rise.

And there is no ceiling on the amount by which retirement rate authority potentially could rise; the only limitation is that any such amount will be phased in over 5 years. Therefore, this rate authority is, in fact, unlimited, restrained only by OPM's annual calculation of required amortization payments and Postal Service total revenues.

Market-dominant mail volumes have been declining for years. Continued volume decreases will spread the burden of the rate increases owing to the amortization payments over fewer pieces. That means ever fewer pieces would be paying ever higher prices.

As day follows night, the rate increases stemming from that authority will simply accelerate further volume decreases, an entirely foreseeable discordant cycle far removed from the "harmonious cycle" upon which the *Revised NPRM* seems premised. The *Revised NPRM* fails to address how this entirely predictable and probable cycle could actually benefit either mailers or the Postal Service.

### E. A Failure On The Part Of The Postal Service To Make The Funding Payment Should Result In The Loss Of All Authority Used To Collect Money In A Given Year

The *Revised NPRM* proposes two conditions presumably intended to assure mailers that the Postal Service uses any money collected through the supplemental retirement rate authority solely for the retirement-related amortization payments. These are:

1. That if the Postal Service were to fail to make amortization payments in amounts at least equal to the revenue generated in the first year from the supplemental authority, it would lose eligibility for future retirement rate authority;

2. In each Annual Compliance Determination after the first year, the Commission "will review the status of partial payments and may order cessation of retirement rate authority if these payments are not made."

*RNPRM* at 93 & Proposed rule § 3010.185(d). The Commission also states that it could impose "additional equitable remedies, including potential adjustments to rates and/or rate authority" if the Postal Service "avails itself of the retirement authority without making partial payments." *Id*.

While the First-Class Business Mailers understand that the Commission intends for any money collected via this authority to be used as intended, enforcement must be much more clear, direct, and effective. As proposed, it appears that the Commission would allow the Postal Service to use the supplemental retirement rate authority in year 1 and not remit any of those funds, with the only consequence being that it would not receive further increments of authority in Years 2 through 5. Instead, the Commission would retain discretion to determine whether the Postal Service would be allowed to continue to collect additional revenue through supplemental retirement rate surcharges. *RNPRM* at 93.

As discussed in Section B above, mailers have seen this movie before and therefore have reason to be skeptical that this time it will have a happy ending. The Postal Service continues to collect the $3.1 billion added to the rate base in Docket No. R2005-1 and is not remitting that money to the Treasury. However, rather than that resulting in a loss of that $3.1 billion authority, the Commission instead now proposes to give the Postal Service a *second* source of additional revenue based on these same obligations, again with no effective means to ensure that the money is remitted for the intended purpose.

This is unreasonable. If the Commission decides to allow supplemental rate authority for retirement amortization payments – which the First-Class Business Mailers oppose as unnecessary and unjustified under Objective 5 --

that money must be used for that purpose alone. That means if, whether in Year 1 or subsequent years, the Postal Service fails to remit those funds in full, it should not only receive no more authority, but the authority that it already has received and used to collect those funds should be rescinded automatically, and the monies collected should be subtracted from the next subsequent grant of authority under this provision.[56]

## VI. THE PROPOSED PERFORMANCE-BASED RATE AUTHORITY SHOULD NOT BE ADOPTED

The *Revised NPRM* proposes to award the Postal Service one (1) percent additional cap authority (about $439 million based on FY2019 market dominant revenue[57]) if two conditions are met: (1) Total Factor Productivity increases over the preceding year, and (2) the Postal Service does not change its published service standards (and related business rules) during that year. *RNPRM* at 105. If TFP fails to improve over the preceding year, the Service would receive no extra authority, nor would it be penalized. As proposed, there would be no sunset of this new authority, but it would be subject to a review in five years.

The current proposal is a modified version of a predecessor presented in Order No. 4258.[58] The primary differences are (1) that no longer would rate

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56 Because 39 U.S.C. §3681 bars refunds, this is the only method to effectively and equitably return funds to mailers that were collected in violation of this provision.

57 *USPS Public FY19-1 CRA Report*, Docket No. ACR2019, Tab Cost 1.

58 The First-Class Business Mailers regret that the Commission did not instead propose to base performance-based rate authority on actual improvements in controllable costs, as suggested in their *Phase II Comments*. That would have more directly focused on the Postal Service's ability to control costs and struck a proper balance between financial rewards and

authority be available separately for TFP and service standards,[59] and (2) that TFP improvement would be based on a comparison to the preceding year instead of a rolling five-year period. *Revised NPRM* at 105. As for the first change, eliminating separate components is administratively simpler and the First-Class Business Mailers support requiring the Postal Service to meet both the TFP and service prongs in order to earn additional authority.

However, the proposal unfortunately remains flawed because it is premised on the misconception that the Postal Service is entitled to retained earnings. Furthermore, the proposals will not ensure either that the Postal Service will become more efficient or that service will be improved (or even that the reduced service standards published today are maintained). Accordingly, this proposal should not be adopted.

### A. The Proposal Lacks A Statutory Basis Because The Postal Service Is Not Entitled To Retained Earnings

The proposal rests on the flawed premise that the Postal Service is entitled to retained earnings. *RNPRM* at 115. That is incorrect. The PAEA merely allows the Postal Service the *opportunity* to retain earnings, a change

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penalties. The Lowry and Wolff monograph on performance-based regulation cited in the *Revised NPRM* states:

> Financial rewards and penalties need to strike the right balance: low enough to mitigate regulatory risk, but strong enough to incentivize correct utility behavior. This balance can sometimes be difficult to achieve.

Lowry & Woolf, *Performance-Based Regulation In A High Distributed Energy Resources Future*, Berkeley Lab Report No. 3, at 3 (January 2016). That is the case here as well.

[59] Order No. 4258 proposed to allocate 0.75 percentage points of rate authority if the Postal Service exceeded a rolling TFP benchmark and 0.25 percentage points if the Postal Service did not reduce any of its published service standards compared to the prior year.

from the previous law under which the Postal Service operated under a break-even constraint.

The Commission understands this, because at times it correctly states that the PAEA "permit[s] the Postal Service to accumulate retained earnings." *RNPRM* at 221-222. However, the *Revised NPRM* has lost sight of the statutory meaning of financial stability.

As the First-Class Business Mailers have pointed out repeatedly, the Postal Service currently enjoys the financial strength to design and maintain the postal services needed by the United States, as required by Section 3622(d)(3). The Service's "vast net losses" and "accumulated deficit" (*RNPRM* at 106) almost entirely consist of phantom accounting losses stemming from the retiree obligations. There is no explanation of how the Postal Service's accounting losses might have caused it to become less efficient or provide poorer service.

The Postal Service had nearly $8.9 billion in cash on hand and $4 billion in borrowing authority at the end of FY2019. *USPS FY19 Annual Report to Congress*, at 11 (Docket No. ACR2019, Library Reference USPS-FY19-17). There is no showing that this is inadequate under a proper definition of financial stability.

That the Postal Service may have a lower level of investment than under cost-of-service regulation is not unexpected, but rather is an intended result of price cap regulation. That fact is merely the starting point for an analysis of the Postal Service's capital investment plans, but the Commission treats it as the conclusion. Nor does history indicate that even greater levels of capital investment would surely lead to improved performance, as the dismal record of the Flats Sequencing System shows.

The *Revised NPRM* makes no serious attempt to show otherwise. The Commission specifically disclaims any effort to determine how much capital the Postal Service needs. *RNPRM* at 121. There is no showing of what level of capital expenditure is appropriate as volume declines. The Commission also declines to conduct a prior review of capital expenditures. *Id*.

Instead, it simply proposes to allow the Postal Service to earn an additional one percent of rate authority per year if it meets the performance conditions. This 1 percentage point "was not intended to provide the Postal Service a specific level of retained earnings or a set amount of funding for capital investment but rather to address deficiencies in the Postal Service's long-term financial stability and provide incentives for the Postal Service to increase operational efficiency and maintain high quality service standards." *RNPRM* at 121.

Why one percent? The *Revised NPRM* says only that the Commission derived that amount in its "expert judgment" by taking into account "multiple reference points." *RNPRM* at 122.[60] This is insufficient to establish reasoned decisionmaking. There is no explanation of how the Commission weighed the (it is unclear how many) "reference points" and how it exercised its judgment. *See*

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[60] These apparently included the Postal Service's capital spending before and after the PAEA, the Postal Service's use of borrowing authority during the PAEA era, possible other unidentified reference points, rate increases under the PAEA, and the "impact" of the proposed supplemental rate authority. *RNPRM* at 122. However, it is clear that the Commission has made no attempt to base the amount on the Postal Service's future capital needs, nor will it trouble to review Postal Service capital investment decisions going forward. *Id*.

*National Association of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 658 (2007) (agency's path must "reasonably be discerned"); *National Lifeline Association v. Federal Communications Commission*, 921 F.3d 1102, 1110 (D. C. Cir. 2019) (agency must articulate satisfactory explanation for its action).

The Commission's explanation of how the one percent would "address deficiencies" in the Postal Service's long-term financial condition appears to be based on a wish and a prayer. It says that the performance-based rate authority would "promote greater capital investment and allow the Postal service to reenter the financial health cycle by providing the Postal Service with additional revenue if it achieves the specific operational efficiency and service standard benchmarks. The financial health cycle requires the generation of 'adequate revenues to ensure net income, which provide retained earnings.'" *RNPRM* at 105. This premise is shaky, as not all of the Postal Service's investments have lived up to their alleged promise, as evidenced by the Flats Sequencing System.

Remember that under the system in place today, the Postal Service already enjoys the full benefits of improved TFP, because it is not required to share productivity with mailers through an X factor. Experience gives little reason to expect that the prospect of still another unshared benefit in the form of additional revenue will cause the Postal Service to become more efficient. This is all the more so because the other proposals in the *Revised NPRM* already would give the Service additional money.

### B. As Designed, The TFP Component Does Not Ensure That The Postal Service Will Minimize Costs Or Maximize Efficiency

The Commission believes that by "obligating the Postal Service to focus its efforts on efficiency gains that increase TFP and maintain its service standards, the proposal acts as both an incentive and a control on the Postal Service's access to and use of any additional funds." *RNPRM* at 114. We submit that the Total Factor Productivity component as proposed is not well-suited for ensuring that efficiency is improved.

### 1. Year-to-year TFP is not a good productivity metric

In previous comments, the First-Class Business Mailers noted that TFP is an imperfect measure of productivity.[61] One reason is that TFP fails to account directly for changes in factor input prices and therefore runs the risk that excessive inflation in factor input prices, including wages, can increase TFP without costs decreasing. Another is that measuring operational improvements by TFP would give the Postal Service a direct incentive to shift postal costs onto mailers without offering workshare or other incentives.[62] There have been many instances in which the Postal Service has shifted costs to mailers, causing them to incur additional expenses for software, hardware, and staffing. Seamless Acceptance is a recent example of such a move. The Commission would need to monitor the Postal Service carefully to ensure that it does not push unrecompensed costs on to mailers in order to obtain the 1 percent increase.[63]

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[61] *First-Class Business Mailers Phase II Comments* at 9 & 73.

[62] For an analysis of the problem of the Postal Service shifting costs to mailers through the imposition of mailing requirements, *see* Office of the Inspector General Audit Report, *Effects of Compliance Rules on Mailers* (Aug. 24, 2011).

[63] For reference, compared to the incentive that the *NPRM* offers the Postal Service, the $.003 and $0.001 incentives for using Full Service IMb that Postal Service gives mailers is far smaller than the costs they incur.

In those comments, the First-Class Business Mailers also noted that despite its shortcomings, TFP might be used on an interim basis until a better metric were developed.[64] However, that was premised on the Phase II proposal to use a rolling TFP average, which allows time for Postal Service investments and adjustments to take effect. We concur with the Postal Service that looking at year-to-year TFP changes is not particularly informative. *See USPS FY2019 Annual Report to Congress*, at 34.

For these reasons, TFP is not a valid metric upon which to award the Postal Service as much as $439 million in additional rate authority on, potentially, an annual basis.

**2. TFP does not ensure that higher revenue leads to better efficiency**

The *Revised NPRM* proposes the "performance authority" as an incentive to encourage the Postal Service to become more efficient. Aside from whether another carrot will materially add to the incentives that the Postal Service faces today to do so since it already pockets all TFP gains, the larger problem is that there is no assurance under this proposal that any efficiency gains can be sustained.

In particular, under the proposal in the *Revised NPRM*, it would be quite possible that the Postal Service could earn the additional one percent in the first

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[64] *First-Class Business Mailers Phase II Comments* at 73. A possible better metric was the "Controllable Cost" approach presented in those comments.

years yet TFP declines for the next few years (despite the additional revenue) culminating in a net overall decline in efficiency. Consider this Table:

| Year | | % TFP Change | | Additional Authority | | Cumulative | |
|---|---|---|---|---|---|---|---|
| | | Annual | Cumulative | Annual | Cumulative | % TFP | Authority |
| | | [2] | [3] | [4] | [5] | [7] | [8] |
| 1 | [a] | 1.85% | | 1.00% | 1.00% | | |
| 2 | [b] | 0.35% | 0.35% | 1.00% | 2.01% | | 1.00% |
| 3 | [c] | 0.06% | 0.41% | 1.00% | 3.03% | 0.06% | 2.01% |
| 4 | [d] | -0.16% | 0.25% | 0.00% | 3.03% | -0.10% | 2.01% |
| 5 | [e] | -0.57% | -0.32% | 0.00% | 3.03% | -0.67% | 2.01% |
| 6 | [f] | -0.01% | -0.33% | 0.00% | 3.03% | -0.68% | 2.01% |
| 7 | [g] | -0.30% | -0.63% | 0.00% | 3.03% | -0.98% | 2.01% |

*See* Attachment 4. Here, TFP change in Year 1 is 1.85 percent, earning 1 percent in additional rate authority, and in Year 2 TFP change is also positive, at 0.35%, earning a second 1 percent. In Year 3, TFP change is slightly positive, earning still another 1 percent. However, TFP change falls in Year 4, and continues to decline in the three following years. After year 7, TFP is negative, compared to Year 1 level, by -0.63 percent. However, had the *Revised NPRM*'s proposal been in effect, the Postal Service would still have 2.01 percent (as compounded) additional revenue despite becoming less efficient.

This is not a mere theoretical concern. In fact, the annual TFP changes shown above are the actual TFP performances for postal Fiscal Years 2013 through 2019. Although the Postal Service did not earn "performance" rate authority during that period, in 2014 through 2016 it received even more rate authority in the form of a 4.3 percent exigent surcharge. Yet despite that extra money, TFP declined.

### 3. To earn a rate award, TFP must not only improve from the prior year, but also must exceed its total level as measured when the incentive starts

To prevent the situation described in the preceding Section from occurring, if the Commission adopts this proposal it must modify it to ensure that any financial reward for improvements in TFP must be based on real improvement in TFP. There are two relevant benchmarks. First, for the Postal Service to earn rate authority, the change in its TFP must be positive (that is, an improvement over the preceding year). The *Revised NPRM* proposes this requirement.

Second, to ensure that any rewards for efficiency improvements are truly based on net positive productivity, the Postal Service should be required to achieve a cumulative TFP that exceeds the TFP level that existed at the beginning of Year 1 of this incentive. That is, if the service performance incentive were to begin in FY2022, any award based on TFP – in any future year -- should have to exceed the TFP reported for FY2021. Thus, for the Postal Service to receive an award after FY2024, total TFP would still have to exceed the FY2021 TFP floor. It is not enough that TFP merely improve in, say, Year 3, if due to a drop in Year 2 the net TFP after Year 3 remains below its level when the counting began.

The Commission's assumption that more dollars will lead to more efficiency through wise investments (*RNPRM* at 133) is not empirically based and in fact is contrary to recent postal history, and experience teaches that more money in fact can lead to less efficiency. But a rate incentive premised on improved efficiency fails on its own terms if efficiency does not, in fact, improve.

For the Postal Service to earn any service performance rate authority, TFP not only must be improved over the previous year, but also the cumulative TFP must exceed the starting year floor. Otherwise, the authority would be contrary to the premise of the incentive and would thus be arbitrary.

#### 4. Service performance rate authority should be reduced if TFP declines

The Commission proposes that the Postal Service would receive no new performance rate authority if TFP falls below that of the previous year. The Service's TFP productivity in recent years suggests that a stronger incentive is necessary. The Service should be *penalized* when it fails to meet the threshold, as a reduction in rate authority -– equal to the additional rate authority the Postal Service could earn -- each year that the target is not met. Conferring rate authority when TFP improves, but not rescinding it when TFP falls, is unbalanced and arbitrary.

Furthermore, as discussed in the preceding section, it is quite possible that TFP could dip below the starting point level. If total TFP (instead of the change in TFP) is below the level of TFP for the year that serves as the starting point for this factor, not only should no new authority be awarded, but *all* service performance rate authority accumulated to that point should be forfeited. If TFP falls below the starting point, then the Postal Service has become less efficient even with the additional money. That would mean that every single additional "service performance" percentage point would have been wasted or ineffective.

The only proper regulatory response to such a failure should be to rescind *all* additional service performance authority immediately.

#### 5. Service performance rate authority should sunset after five years

The Revised NPRM proposes to make service performance rate authority not only one-directional, but also permanent. Once earned, all of the awarded percentage points would become permanently embedded in the rate base and the Postal Service's would have the opportunity to earn this percent annually forever (subject only to a Commission review five years hence): "The incentive mechanisms are intended to operate as a permanent part of this new system and are not subject to sunset." *RNPRM* at 147.

Service performance rate authority should not be permanent, at least as long as it can only go up. At most, the Commission should sunset it after five years, and revisit the issue when it reviews the entire system at that time. Otherwise, the Postal Service could continue to accumulate these percentage points throughout the duration of that review.

### C. The Postal Service Should Not Receive Any Additional Rate Authority Unless It Meets Its Service Standards

Objective 3 provides that the regulatory system shall be designed:

> To maintain high quality service standards established under section 3691.

39 U.S.C. §3622(b)(3). In Order No. 4257, the Commission stated: "A system achieving Objective 3 is designed to encourage the maintenance of high quality service standards established pursuant to 39 U.S.C. §3693, *and to hold the*

*Postal Service accountable for consistently achieving those standards*." *Id*. at 261 (emphasis added).[65] The Commission found that the Postal Service had reduced the high quality service standards originally set in 2007 and concluded therefore the regulatory system had not achieved Objective 3. *Id*. at 273.

The *Revised NPRM*, as did Order No. 4258, once again proposes to allow the Postal Service to receive a "performance-based" rate adjustment for doing nothing other than simply not reducing the service standards (and associated business rules) in place at the beginning of the fiscal year.[66] There would be no requirement that the Postal Service actually meet the its published standards, much less that it improve them. Instead, the Postal Service could check this box literally by doing nothing. But that would do nothing to ensure high quality service.[67]

This proposal should be modified to require that the Postal Service actually achieve its published standards, that it not reduce them, and that a failure to achieve the standards would result in a forfeiture of rate authority.

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[65] The Advance Notice of Proposed Rulemaking that commenced this docket had proposed to evaluate that the regulatory system had achieved Objective 3 -– *i.e.*, that the system has maintained high quality service standards -– if it were designed for the Postal Service "to consistently *achieve*, for each class of mail, stated days to delivery at a desired target rate." Order No. 3673 at 5 (emphasis added). However, in Order No. 4257 the Commission discarded this focus on actual service, instead couching the test as whether "high quality service standards have been maintained, as contemplated in Objective 3." Order No. 4257 at 249.

[66] *See* Proposed rule § 3010.202(a).

[67] The Office of the Inspector General reports that the Postal Service "does not know how much it would actually cost to meet its current service performance targets or the financial and customer service impacts of reducing the targets." Office of the Inspector General, *Assessment of the U.S. Postal Service's Service Performance and Costs*, Report No. NO-AR-19-008, at 2 (Sept. 17, 2019).

Furthermore, the Commission must act to improve the transparency of the business rules.

### 1. The proposal must be amended to require that the Postal Service achieve or exceed its performance standards

#### a. The *Revised NPRM*'s interpretation of Objective 3 that focuses on "standards" fails to take into account Factors regarding performance

Although the *Revised NPRM* summarizes the extensive comments on the previous proposal to base service performance on published standards instead of actual performance (at 137-138), nowhere does it explain why a focus on standards – as opposed to performance -- is appropriate. We presume that the Commission's continued use of standards, not actual performance, is based on the comments of the Postal Service asserting that Objective 3 focuses on standards, not performance. *RNPRM* at 138, *citing Postal Service Reply Comments* at 86. This erroneously overlooks other relevant provisions of the PAEA.

By law, the Commission must, when revising the system for regulating market dominant rates, "take into account" the Factors in Section 3622(c). The very first Factor is "the value of the mail service actually provided each class or type of mail service to both the sender and the recipient." 39 U.S.C. §3622(c)(1).[68] That Factor clearly emphasizes actual service provided to

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[68] As the Commission previously recognized, Factors 1 and 4 highlight that a decline in service *performance* is "tantamount to a decline in the overall value of the mail as a service" -— a factor affecting rates. Order No. 4257 at 256. However, the Commission then ignored those Factors in proposing to condition service performance authority on maintaining – instead of achieving – service standards.

mailers, not the published standards. Factor 4 also require consideration of alternative means of sending letters, which implicitly implicates actual performance. 39 U.S.C. §3622(c)(4). In addition, Factor 9, which highlights the importance of "providing classifications with extremely high degrees of reliability and speed of delivery" and of those that "do not require high degrees of reliability and speed of delivery" similarly implies a similar emphasis on "providing" – not "advertising" -- actual reliability and speed.

Focusing solely on Objective 3's reference to "standards" without taking into account the focus on actual performance in Factors 1, 4, and 9 is an incorrect reading of the law.[69] The focus of this incentive should be actual, not advertised, performance.

Moreover, providing additional authority predicated only upon the formal standards ignores the statutory requirements applicable to creating the standards in the first place. Section 3691 both implicitly and explicitly incorporates performance into the development of service standards. Objectives B and C -- and, to a lesser extent, Objective A -- plainly imply performance is a key metric in devising and sustaining service standards. 39 U.S.C. §3691(b)(1) Objective D explicitly references service. But the clearest indication of what Congress had in mind is subsection (c), which sets forth factors to be taken into account. Factor (2) thereunder states: "the degree of customer satisfaction with Postal

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[69] Indeed, in Order No. 4257 the Commission itself found that "Objective 3 implicitly requires consistent achievement of those standards" yet nonetheless disregarded its own finding in fashioning its precursor to the current proposal. Order No. 4257 at 262.

Service performance in the acceptance, processing and delivery of mail." 39 U.S.C. §3691(c)(1).

Clearly, Congress had the common sense understanding that standards and performance cannot be divorced and treated separately. Performance is inherent in standards; otherwise the standards are empty words. That Congress intended for them to be considered together is apparent. The Commission cannot ignore Section 3691 and must apply standards and performance together consistent with that section, in setting this incentive for improvement.

When the current regulatory regime was adopted, the Commission declined to include "at this time" an adjustment in the price cap system to reflect degradations in service. Order No. 43, Docket No. RM2007-1, at 45 (Oct. 29, 2007). The Commission stated instead that accountability would come through increased transparency, and that it "is obligated to developed appropriate regulations" if experience showed that service quality was not being achieved. *Id*., at 46. Since then, service quality has declined, as published standards have been weakened, but the Postal Service is not achieving even the lesser standards. Yet it has suffered no cap consequences, and the Commission has not exerted its rate regulatory authority to require improved actual service quality.

Instead, the Commission's review of *actual* service performance has been relegated to the Annual Compliance Review process rather than the rate adjustment process. Hortatory admonitions in an Annual Compliance Determination would ring hollow if the Commission nonetheless gives the Postal Service more rate authority. A non-binding slap on the wrist in an ACD is a small price to pay for $439.8 million in rate authority (one percent of FY2019 market-dominant revenues).

### b. The Postal Service does not achieve even today's reduced service standards

As the *Revised NPRM* recognizes, with a price cap system there is a "potential to cut costs by way of service reduction to comply with price cap requirements." *RNPRM* at 142. The Commission acknowledges that the Postal Service reduced the published service standards several times between 2007 and 2017.[70]

However, the Postal Service has consistently failed to achieve even these reduced standards. In the recently filed Annual Compliance Report for FY2019, the Postal Service reported that it had yet again failed to achieve any of the First-Class Mail service standards. *USPS-FY19-29 Service Performance Report*, Docket No. ACR2019, at 3. It achieved only two of the nine targets for USPS Marketing Mail. *Id*., at 11. And the Postal Service itself understands full well that improvement is needed. *ACR FY2019* at 39.

There is no question that the Postal Service's published service standards serve important purposes. One is that they provide a basis around which it organizes its internal operations in an effort to meet those standards.

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[70] *RNPRM* at 142. *E.g., Network Rationalization and Load Leveling,* Docket No. N2012-1 (Sept. 28, 2012); *see also Service Standards for Destination Sectional Center Facility Rate Standard Mail*, 70 Fed. Reg. 12390 (Mar. 5, 2014) ("*Load Leveling*"). Unfortunately, the Postal Service did not realize the cost savings it anticipated. *See* Office of Inspector General, *Mail Processing and Transportation Operational Changes*, Audit Report 16-009, at 2 (Sept. 2, 2016).

But another important purpose is for marketing. Published service standards advertise to the universe of potential mailers what service to expect. The more attractive the standards, the more attractive are the Postal Service's products. That may be the basis for the Commission's statement that: "Maintenance of high quality service standards promotes demand for postal products, which leads to increased revenue." *RNPRM* at 105, *quoting* Order No. 4258 at 46. However, promoting demand only leads to increased revenue if the service provided matches the service advertised.[71]

Published standards may attract customer interest, but it is *achieving* high quality service standards that promotes demand for postal products. When the *reality* of performance fails to meet the expectations created by the marketing, the Postal Service is seen as unreliable, mailers redouble efforts to transition to digital alternatives, and volume falls. Consumer protection agencies, not to mention consumers themselves, might consider advertising a performance that is not achieved to be misleading. Volume history strongly suggests that the Postal Service's repeated failures to achieve published service standards – which have been reduced several times in the past decade – has been a critical factor in driving mailers away.

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[71] The *Revised NPRM* cites the Copenhagen Economics Report to the effect that "changes in the price cap triggered by changes in service performance should mirror postal service users' willingness to pay for higher quality." *RNPRM* at 142. However, mailers today are not receiving the service that they are paying for, and under this proposal they would pay still more without any assurance of higher quality.

Nothing in the *Revised NPRM* would prevent the Postal Service from reducing the actual quality of service mailers receive in any number of ways short of actually taking the trouble to tinker with the text of the standard. Even if the Postal Service were to suffer from mismanagement or incompetence, or to deliberately engage in a pattern of slowing processing or transportation, so long as it were careful not to alter the published business rules and to avoid filing a case with the Commission, it would receive its additional cap authority.

Focusing on standards alone address only the formalities but does not address either the repeated failure to achieve them or the statutory Factors. If the rate regulatory system is to be used as an incentive for service quality, it must cause the Postal Service to meet and exceed what it tells mailers that it will do. "Service performance-based" rate authority must be based on the service actually experienced by mailers, not on published standards that promise a level of service not achieved in years.

#### c. Service performance rate authority granted under this proposal should be removed if the Postal Service reduces service standards in the future

The Commission does not propose to reduce any acquired rate authority if the Postal Service in the future reduces its published standards. *RNPRM* at 142-43. The statute does not entitle the Postal Service to retain rate authority earned for a particular purpose in perpetuity if it subsequently abandons the rationale for which it was conferred. To be balanced, a penalty in the same percentage amount should apply to any failure on the part of the Postal Service to meet or achieve the service standards.

The Commission states that the Postal Service "may have justified reasons for reducing its high quality service standards and the statute under the PAEA does not prevent it from doing so." *Revised NPRM* at 143. That is true. Yet that the Postal Service in the future may have reason for officially degrading its service still further does not mean that it is entitled to revenue collected on the basis of a previous, higher standard that has now been abandoned. It is eminently reasonable that a price for reducing service standard should include the loss of rate authority that has been premised on maintaining the current standards.

**2. If the Postal Service's business rules are part of the standard, they must be made more transparent**

The Commission proposes to include the Postal Service's service performance business rules in the "service standards" that must be maintained in order to earn the 1 percent "performance" rate authority. Proposed rule §3010.202, in defining the service standard-based requirement, states that:

> The service standard-related criteria are met if all of the Postal Service's service standards (including applicable business rules) for that class during the applicable fiscal year meet or exceed the service standards in place for the prior fiscal year on a nationwide or substantially nationwide basis as determined by the Commission.

The First-Class Business Mailers support including the business rules because changing the business rules can essentially change the service standard. However, there is limit transparency into these rules -- which define in part how the measurement start-the-clock and stop-the-clock dates are determined. Nor is there any public process in which industry can comment upon changes. If rate authority depends upon these rules not changing, the Commission must make them become more transparent.

The only access that industry has to the Postal Service's business rules occurs when the Service provides them to the Commission in a public proceeding that deals with service performance. Industry last had access to the business rules in Docket No. PI2018-2, where the Postal Service provided a copy of its overall Service Performance Measurement Plan in a Library Reference. *See* Docket No. PI2018-2, *USPS-LR-PI2018-2/1*, revised Sept. 2018 (the business rules are included in Section 10, Appendix, of the plan). To our knowledge, there is no current Commission process or oversight when the Postal Service makes changes to the business rules, thus no opportunity for industry access to the information or ability to comment.

The First-Class Business Mailers do not know whether changes to the business rules have been made by the Postal Service since their inclusion in the 2018 library reference. If any changes have been made, there was no public process where mailers could be made aware of them or provide comments. But it is possible that changes have occurred, because the business rules last published in 2018 (as above) contained references to "current state" and "future state" but no hint as to when any "future state" changes might be made.

The business rules are a critical piece of this proposed requirement because they determine not only the start and stop-the-clock but also requirements as to when mailers/MSPs must enter mail to the Service to start-the-clock (*i.e.*, Critical Entry Times) as well as other factors for service performance measurement. For example, if the Postal Service were to change the Critical Entry Times, which are contained in the business rules, to require mail to be entered earlier than most businesses can achieve in order to have the entry day be start-the-clock Day 0, that effectively would reduce service standards because it would add an additional day to when the clock starts for service performance. Some changes in business rules, however, would not negatively impact the service standard, so each specific change would need to be reviewed and a determination made as to whether they in effect change a service standard.

Related to the lack of transparency or process around changes to business rules is the question of how the Commission would determine whether any changes in a business rule “meet or exceed” those in place for the prior fiscal year. Would a comparison of business rules year-over-year be part of any Commission proceeding to determine whether the Postal Service has met this requirement? If so, that implies that the Commission will need to add a requirement that the Postal Service submit them.

For these reasons, while the First-Class Business Mailers support including the business rules in the requirements that the Postal Service would need to meet to achieve the additional 1% rate authority, the Commission must ensure that these rules are transparent, that there is a public process when any changes to business rules are made, and the Commission have a process in which it can assess whether a change in business rules negatively impacts the service standards.

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A “reward” for service should not be based on simply refraining from changing published standards and business rules that the Postal Service is under no legal obligation to meet and that in practice it can effectively rescind or let deteriorate. While high quality service standards and business rules are desirable, more important to mailers is that the Postal Service’s actual performance meets or exceeds standards.

## VII. THE COMMSSION SHOULD SEQUENCE THE ORDER IN WHICH RATE AUTHORITY IS USED IN ORDER TO PREVENT PROHIBITED BANKING

If the Commission were to adopt the proposals in the *Revised NPRM*, it must stipulate the sequence in which supplemental or additional rate authority may be used. This is necessary to ensure that the Postal Service does not “bank” authority contrary to the Commission’s intention, as the new authorities would expire under various conditions.

In particular, as proposed:

1. “Density rate authority” would lapse if unused within 12 months of being authorized, and the Commission would specifically forbid it from being used “to generate unused rate authority” or from affecting “existing banked rate authority.” (Proposed rule § 3010.160(c)(4));

2. The supplemental retirement rate authority must be used at least in the first year after being authorized (Proposed rule § 3010.185(b));

3. The additional 1 percent of “performance-based rate authority” will lapse if unused within 12 months of being authorized. *RNPRM* at 149-150 & proposed rule §3010.200(c)(3) & (4); and

4. The additional 2 percent rate authority for non-compensatory classes is optional but may “not be used to generate unused rate authority, nor

> shall it affect existing banked rate authority.' *RNPRM* at 174 & Proposed rule § 3010.222(a) & (b)(4).[72]

Given that these rate authorities will expire if unused, and either specifically prohibit banking or, by their nature, cannot be "banked," the Commission must ensure that they are not banked indirectly.

The problem is simple. If the Postal Service were to raise rates by the maximum CPI adjustment, but not apply any of the additional or supplemental rate authorities proposed in the *Revised NPRM*, no authority would be "banked" because the CPI authority would be fully consumed and, under the proposal, none of the others could be banked.

In contrast, if the Postal Service were to try to raise rates by the same percentage (as in the preceding paragraph) using one or more of these new authorized supplemental or performance based authorities, but not claim to use a CPI adjustment, that would have the effect of banking the CPI authority. That would create "unused rate authority" in contravention of the proposed rule.

Accordingly, to prevent "banking" of rate authority, in any rate increase the Postal Service must first apply any inflation-based rate authority under the Consumer Price Index. Given that the CPI is the only authority that can be "banked," it is necessary that it be the first consumed in order to prevent impermissible banking of the other authorities.

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[72] In contrast, the required 2 percent rate increase above class average for non-compensatory products within an overall compensatory class "does not create additional rate authority for the entire class." *RNPRM* at 153-154.

## VIII. THE PROPOSAL TO RELY ON MORE REPORTING REQUIREMENTS – INSTEAD OF FINANCIAL PENALTIES -- RESTS ON AN APPROACH THAT HAS FAILED REPEATEDLY TO IMPROVE POSTAL SERVICE PERFORMANCE

In the *Revised NPRM,* the Commission recognizes that the increased revenues that it proposes to authorize could weaken the Postal Service's incentive to reduce costs, contrary to Objective 1. *RNPRM* at 222. The Commission proposes to offset this effect by establishing new reporting requirements regarding its cost reduction efforts, which the Commission hopes "should provide additional impetus for it to pursue continued cost reductions. *Id*., at 223.

In particular, proposed rule § 3050.55 would require the Postal Service to submit reports on changes in unit costs, specific cost reduction initiatives, and Decision Analysis Reports. In part, these new reporting requirements correspond to suggestions that the First-Class Business Mailers made in their *Phase II Comments*. The First-Class Business Mailers do not oppose these reporting requirements; in fact, we believe that the Commission should also require the Postal Service to report on density or on efforts to increase density (such as by encouraging more volume), inasmuch as the *Revised NPRM* regards density declines as a major problem.

However, one wonders about the utility of reports in the absence of more rigorous enforcement. The Commission states it would require "the Postal Service to focus its efforts on identifying the underlying causes of cost increases and developing concrete plans to reduce costs." *RNPRM* at 223. But presumably the Postal Service does so today. Its Annual Compliance Reports and Reports to Congress frequently tout its initiatives to address costs, service or other needs. To be sure, the details are not now filed with the Commission, but the proof is in the pudding of whether its initiatives are effective. To date, too many have not been.

For example, the Commission acknowledges that "requiring more transparency, requiring additional reporting, and directing the Postal service to reduce costs, have not eliminated the problem of underwater products." *RNPRM* at 157. Consequently, the Commission decided to regulate the rates of underwater products more directly and proposes to amplify its regulations in this proceeding. *Id*. The Postal Service's continued inability to reduce costs should require a stronger remedy than simply more transparency and additional reports.

The Commission's faith in still more reporting requirements, without firmer enforcement sanctions, flies in the face of a history of their ineffectiveness.[73] Prior review of major cost reduction initiatives or capital investment programs would have more teeth. The Commission's suggestion to require reporting on "mid-implementation adjustments made to align actual results to expected results" is potentially worthwhile, but as proposed would apply only to Cost Reduction Initiative reports. *RNPRM* at 230-31. Mid-implementation adjustment reports should be required for Decision Analysis Reports as well. Even more

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[73] It is not just reporting to the Commission that is problematic. OIG reports also have identified numerous problems over the years but have resulted in few real improvements. *E.g., Challenges in Controlling Costs with Standard Mail Flats and Periodicals*, OIG Report No. SM-WP-15-001 (Feb. 26, 2015); *Flats Sequencing System Performance in the Capital Metro Area*, Report No. NO-AR-18-008, at 2 (July 26, 2018) (stating "it is unclear whether processing flats on FSS is actually more cost-efficient than using AFSM"). *See also* General Accountability Office, *U.S. Postal Service: Delivery Mode Conversions Could Yield Large Savings, but More Current Data Are Needed* (May 2014).

effective would be financial penalties, in the form of reduced rate authority, for unsuccessful initiatives.

## IX. PROCEDURAL CHANGES

The *Revised NPRM* proposes several changes to the procedural timetable governing the consideration of notices of rate adjustments for market-dominant mail. The First-Class Business Mailers support codifying the overall 90-day notice requirement, which reflects current practice.

However, the First-Class Business Mailers oppose the proposal to remove the existing regulatory requirement that the Postal Service explain how noticed rate adjustments comply with the Objectives and Factors in Section 3622(b) and (c). In *Carlson*, 938 F.3d at 343, the Court of Appeals held that "the PAEA requires consideration of all relevant statutory objectives and factors as part of the regulatory process *and does not authorize the Commission to defer evaluation of those objectives and factors until after it approves a rate change*" (emphasis supplied).[74]

The *Revised NPRM* appears to assume that the Commission can avoid the need to consider the Objectives and Factors in rate cases simply by deleting its current regulation directing the Postal Service to explain how the changed rates conform to those criteria. *RNPRM* at 240 & n.328.[75] It does so on the

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[74] The Commission may not "simply disregard the objectives and factors when approving rate adjustments." *Newspaper Association of America v. Postal Regulatory Commission*, 734 F.3d 1208, 1210 (D.C. Cir. 2013).

[75] The proposed deletion of specific reference to the Objectives and Factors from the procedural regulations appears to be an attempt to address those parts of the *Carlson* decision that cited the current regulations adopted in Order No. 43 (which the Court referred to as the

basis of a passing comment in the Court's opinion noting that Congress gave the Commission "leeway" to establish a process for considering the Objectives and Factors. 938 F.3d at 344 (*citing* 39 U.S.C. §§3622(a)-(c).

But that leeway does not empower the Commission to regard its consideration of the Objectives and Factors as complete once it has designed a regulatory system. It does not follow that any rate that satisfies the requirements of that system thereby automatically satisfies the Objectives and Factors and consequently magically becomes immune from pre-implementation challenge. The Commission may not "disregard the objectives and factors" when approving rates, because its orders must satisfy the Administrative Procedure Act requirement to be "reasonably explained." *Carlson*, 938 F.3d at 344. And the Court further stated that the Commission must "Of course" consider "all relevant statutory objectives and factors" raised in public comments. *Id*., at 345.

So even if the Commission were to delete from its procedures governing market-dominant rate adjustments the specific references to the Objectives and Factors, it would continue to have an obligation to address them in approving rates, and particularly those raised in public comments.

Finally, the Commission's proposal to "discontinue" considering the Objectives and Factors in rate adjustment procedures runs flatly contrary to the Court's rejection of such an approach. "We also reject the Commission's argument that it can satisfy the PAEA by deferring consideration of the statutory

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"system regulation"). The problem with that approach is that the Court only partly relied on the text of the current regulation, but also rested its decision on the text of the PAEA and the APA.

factors and objectives until its annual compliance review or in the adjudication of individual complaints." *Carlson*, 938 F.3d at 350. The Court noted the inadequacy of such post-implementation review of rates.[76] Indeed, in most years, by the time the Commission completes its Annual Compliance Determination (a process in which the Postal Service does not address, and in which the Commission specifically does not invite comment on, the Objectives and Factors), any rate then found unlawful has been superseded by an intervening new rate.

As the Commission cannot, consistent with *Carlson*, avoid addressing the Objectives and Factors during its pre-implementation review of rate changes, the Commission's decisionmaking would be improved if it had the benefit of the Postal Service's opinion as to how its proposed rates would satisfy those criteria. The Commission should continue to require the Postal Service to address the Objectives and Factors in notices of market-dominant rate adjustments.

## X. CONCLUSION

For the foregoing reasons, the Commission should adopt the proposed worksharing regulations, which it has authority to do under the PAEA without affecting the price cap. We suggest that it do so in a separate order. However, the Commission lacks legal authority to adopt, and as a matter of regulatory prudence should not adopt, the proposals relating to supplemental or additional

[76] The Court noted that post-implementation review shifts the burden of proof off of the Commission and leaves the mailer without a remedy. *Carlson*, 938 F.3d at 350, *citing* 39 U.S.C. §3681.

rate authority due to density, retirement prefunding, or productivity and service. Those proposals are not well tailored to the stated objectives and would set the stage for a death spiral of declining volumes and increasing rates.

Burdening mailers of declining volume market dominant products with higher rates should be the last resort, not the starting point. Better would be to focus on other revenue options we presented in Phase II and encouraging mail growth.

For the foregoing reasons, the First-Class Business Mailers respectfully urge the Commission to take these comments into consideration.

Respectfully submitted,

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**Attachment 1: City & Rural Carrier Institutional Costs and Delivery Points From 2007 to 2019**

| | | |
|---|---|---|
| FY 2013 Additional Delivery Points | [1] | 723,310 |
| FY 2013 Rollforward Cost | [2] | $73,370,016 |
| Cost per Additional Delivery Point | [3] | $101.44 |

| | | |
|---|---|---|
| CPI-U – FY 2007-FY 2019 | [4] | 23.9% |
| FY 2007 Delivery Points | [5] | 147,992,552 |
| FY 2019 Delivery Points | [6] | 159,901,312 |

| **Rural Carrier & City Carrier Street Time Institutional Costs ($000s)** | | |
|---|---|---|
| FY 2007 | [7] | $10,682,073 |
| FY 2007 (Inflated to FY 2019) | [8] | $13,233,124 |
| FY 2007 (Adjusted to FY 2019 Delivery Points) | [9] | $14,441,110 |
| FY 2019 | [10] | $13,540,336 |
| FY 2019 Institutional Cost Reduction from FY 2007 Inflated & Delivery-Point Adjusted | [11] | ($990,774) |

[1] Docket No. R2013-11, USPS-R2020-4R/8, Input_12.xls, "Non-vol Wkld", cells E18:F20
[2] Docket No. R2013-11, USPS-R2020-4R/8, FY2013BR.CompSumRpt.BR-Final.xls, "ComponentSummary", cell G300
[3] = [2] / [1]
[4] https://www.bls.gov/data/
[5] 2011 Annual Report to Congress and Comprehensive Statement on Postal Operations, p. 23
[6] United States Postal Service FY2019 Annual Report to Congress, p. 14
[7] Docket No. ACR2007, USPS-FY07-2, FY07.Seg&CompRpt.xls, "CSSummary", cell H46 + J46
[8] = [7] * [4]
[9] = [8] + (([6] – [5]) * [3])/1000
[10] Docket No. ACR2019, USPS-FY19-2, fy19public cost segs and comps.xlsx, "CSSummary", cell G59 + I59
[11] = [9] – [10]

## Attachment 2: Comparison of Rural & City Carrier Street Time Institutional Costs per Delivery Point v. CPI-U (FY 2007 – FY 2019)

| | | Delivery Points | Rural & City Carrier Street Time | | CPI-U |
|---|---|---|---|---|---|
| | | | Institutional Costs ($000s) | Inst. Cost per Delivery Point | |
| | | [a] | [b] | [c] | [d] |
| FY 2007 | [1] | 147,992,522 | $10,682,073 | $72.18 | 205.338 |
| FY 2019 | [2] | 159,901,312 | $13,540,336 | $84.68 | 254.376 |
| % Change FY 2007 to FY 2019 | [3] | 8.0% | 26.8% | 17.3% | 23.9% |

[1][a] 2011 Annual Report to Congress and Comprehensive Statement on Postal Operations, p. 23
[1][b] Docket No. ACR2007, USPS-FY07-2, FY07.Seg&CompRpt.xls, "CSSummary", cell H46 + J46
[2][a] United States Postal Service FY2019 Annual Report to Congress, p. 14
[2][b] Docket No. ACR2019, USPS-FY19-2, fy19public cost segs and comps.xlsx, "CSSummary", cell G59 + I59
[1][c]:[2][c] = [a] * 1000 / [b]
[1][d]:[2][d] https://www.bls.gov/data/
[3] = [2] / [1] – 1

## Attachment 3: Density Authority Using USPS Five-Year Plan

| | | FY2019 | FY2020 - FY2024 | FY2020 | FY2021 | FY2022 | FY2023 | FY2024 |
|---|---|---|---|---|---|---|---|---|
| | | [a] | [b] | [c] | [d] | [e] | [f] | [g] |
| Total Mail Volume (millions) | [1] | 142,570 | -18% | 137,437 | 132,305 | 127,172 | 122,040 | 116,907 |
| Delivery Points | [2] | 159,901,312 | 6.9 million new | 161,281,312 | 162,661,312 | 164,041,312 | 165,421,312 | 166,801,312 |
| % of Institutional Costs | [3] | | | 43.9% | | | | |
| Density Authority | [4] | | | 1.944% | 2.00% | 2.06% | 2.12% | 2.20% |
| Cumulative Density Authority | [5] | | | 1.944% | 3.98% | 6.12% | 8.38% | 10.76% |

[1][a]:[2][a] United States Postal Service, FY2019 Annual Report to Congress, p. 1

[1][b]:[2][b] The U.S. Postal Service Five-Year Strategic Plan FY2020-FY2024, p. 15

[1][c]:[1][g] Linear decline of [1][a] by [1][b]

[2][c]:[2][g] Linear increase of [2][a] by [2][b]

[3] Docket No. ACR2019, USPS-FY19-1, Public_FY19CRAReportRev.1.10.2020.xlsx, "Cost3", cell F34 / cell F35

[4] = (Current Year [1] / [2]) / (Prior Year [1] / [2]) -1 * -1 * [3]

[5] = Cumulative of [4]

## Attachment 4: TFP Proposal Using TFP Changes Since 2013

| | | | **% TFP Change** | | **Additional Authority** | | **Cumulative** | |
|---|---|---|---|---|---|---|---|---|
| | | **TFP** | **Annual** | **Cumulative** | **Annual** | **Cumulative** | **% TFP** | **Authority** |
| **Year** | | [1] | [2] | [3] | [4] | [5] | [7] | [8] |
| 2013 | [a] | 1.259 | 1.85% | | 1.00% | 1.00% | | |
| 2014 | [b] | 1.263 | 0.35% | 0.35% | 1.00% | 2.01% | | 1.00% |
| 2015 | [c] | 1.264 | 0.06% | 0.41% | 1.00% | 3.03% | 0.06% | 2.01% |
| 2016 | [d] | 1.262 | -0.16% | 0.25% | 0.00% | 3.03% | -0.10% | 2.01% |
| 2017 | [e] | 1.255 | -0.57% | -0.32% | 0.00% | 3.03% | -0.67% | 2.01% |
| 2018 | [f] | 1.255 | -0.01% | -0.33% | 0.00% | 3.03% | -0.68% | 2.01% |
| 2019 | [g] | 1.251 | -0.30% | -0.63% | 0.00% | 3.03% | -0.98% | 2.01% |

[1][a]:[2][f] USPS Annual Tables, FY 2018 TFP (Total Factor Productivity), table annual 2018 - 2018 cra public.xlsx, "Tfp-52"

[1][g] = [1][f] * (1 + [2][g])

[2][g] United States Postal Service, FY2019 Annual Report to Congress, p. 34

[3] Cumulative of [2]

[4] = if [2] > 0, then 1%, otherwise 0%

[5] Cumulative of [4]